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CURRENCY AND BANKING

NATIONAL PLANNING COMMITTEE SERIES

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Chemical Industries

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NATIONAL PLANNING, ITS PRINCIPLES & ADMINISTRATION — *K. T. Shah.*

NATIONAL PLANNING COMMITTEE SERIES

(Report of the Sub-Committee)

CURRENCY AND BANKING

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Secretary

Prof. C. N. VAKIL

Edited by

K. T. SHAH

Honorary General Secretary

NATIONAL PLANNING COMMITTEE

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Shri Debi Prasad Khaitan

PREFACE

The National Planning Committee, appointed in 1938, began its work early in 1939. After defining the nature of a National Plan, and determining the nature and scope of the work entrusted to them, the Committee issued an elaborate and comprehensive Questionnaire which was subsequently supplemented by specific details. Twenty-nine Sub-Committees, formed into eight groups, were set up with special terms of reference to deal with all parts and aspects of the national life and work in accordance with a predetermined Plan.

After some unavoidable delay in getting replies to the Questionnaire, the Sub-Committees began their work, and submitted Reports,—some of them Final, some Interim,— which were considered at the Plenary Sessions of the Parent Committee in 1940. Towards the end of that year the Chairman, Pandit Jawaharlal Nehru, was arrested and sentenced to a long term of imprisonment, during which the work of the Committee had necessarily to be suspended.

On his release a year later, hope revived for an intensive resumption of the Committee's work. But the outbreak of war with Japan, the threat to India's own safety, and the hectic march of political events, rendered it impossible to devote any attention to such work at that time. It, therefore, inevitably went into cold storage once again; and remained for the duration of the war.

When at last the War seemed nearing its end, Pandit Jawaharlal Nehru with other leaders was released. The moment seemed again opportune to resume the work of

the Planning Committee. Meetings of that Body were held in September and November 1945, when certain more urgent questions, already included in the programme of the National Planning Committee, were given a special precedence. A Priority Committee was appointed to report upon them. Changes and developments occurring during the War had also to be taken into account; and another Committee was appointed to review the general instructions, given six years earlier to the Sub-Committees. Revised instructions were issued to them following the Report of this Sub-Committee; and the Chairmen and Secretaries of the several Sub-Committees were once again requested to revise and bring up to date such of the Reports as had already been submitted—either as final or interim—while those that had not submitted any reports at all were asked to do so at an early date.

As a result, many of the Sub-Committees which had not reported, or had made only an Interim Report, put in their Reports, or finalised them. The Parent Committee has had no chance to review them, and pass resolutions on the same. But the documents are, by themselves, of sufficient value, prepared as they are by experts in each case, to be included in this Series.

The following Table shows the condition of the Sub-Committees' work, and the stage to which the Planning Committee had reached in connection with them.

Serial No.	Name of the Sub-Committee.	Final Report		Interim Report		No Reports
		N.P.C. Resolutions	Not considered by N.P.C.	N. P. C. Resolution	Not considered by the N.P.C.	
Group I.	**Agriculture & other Sources of Primary Production**	Handbook Pp.		Handbook Pp.		
1.	Rural Marketing and Finance	97-99				
2.	River Training and Irrigation Part I	83-85				
	,, ,, ,, Part II	113-115				
3.	Soil Conservation and Afforestation	115-119				
4.	Land Policy and Agriculture			139-141		
5.	Animal Husbandry and Dairying	87-89				
6.	Crop Planning and Production				do.	do.
7.	Horticulture	102-103				
8.	Fisheries		do.			
Group II	**Industries or Secondary Sources of Production**					
1.	Rural and Cottage Industries					
2.	Power and Fuel		do.			
3.	Chemicals					do.
4.	Mining and Metallurgy			77-79		
5.	Engineering Industries	75-77		130-133		
6.	Manufacturing Industries		do.			
7.	Industries connected with Scientific Instruments		do.			
Group III	**Human Factor**					
1.	Labour	89-92				
2.	Population	85-87				
Group IV	**Exchange and Finance**					
1.	Trade					
2.	Public Finance			130		do.
3.	Currency and Banking			122-126		
4.	Insurance			93-95		
Group V	**Public Utilities**					
1.	Transport			95-97		
2.	Communications	126-129		120-122		
Group VI	**Social Services—Health and Housing**					
1.	National Housing	99-100				do.
2.	National Health			152-154		
Group VII	**Education**					
1.	General Education			138-139		
2.	Technical Education				do.	
Group VIII	**Woman's Role in Planned Economy**	154-160				

To sum up, fourteen Sub-Committees had made final reports, of which ten have been considered, and Resolutions taken upon them, by the National Planning Committee. Twelve more have presented Interim Reports, of which nine have been considered by the Planning Committee, with Resolutions thereon, while three Sub-Committees have not yet presented any report on the reference made to them.

The idea that all this material, gathered together with the help of some of the best brains in India in the several departments of our national life, should be printed and published was before the Committee from the start. But the interruption caused by the war prevented its realisation. It was once again mooted in 1941; but the moment was not deemed ripe then for such action, partly because the leading spirits in almost every one of the Sub-Committees were unable to devote time and labour to bring their Reports up-to-date; and partly also because war-time restrictions or shortages had made scarcer than ever before the statistics and other facts, which particular sub-committees would need, to bring their work up-to-date. The war-time needs of Government had attracted several of them to work on Government Bodies, Panels, or Committees. For all these reasons it was deemed undesirable that material of this character—valuable as it must be—should be put out in an incomplete, inchoate, obsolete form, which may reflect unfavourably upon Indian capacity for such tasks.

The last four years of the War were thus a period of suspended animation for the National Planning Committee. Even after the end of the war, it has not been feasible, for obvious reasons, for the Planning Committee to resume its work and finalise decisions. Continuous sessions of that body are indispensable for considering and taking decisions on the Sub-Committee reports presented since 1940, and putting all the material into shape, ready for publication, not to mention making its own Report; but the political situation in the country made it impossible. Other conditions, however, are somewhat more favourable than in 1938-39, when the Central Government of the country were all but openly hostile to such attempts. Lest, however, the momentary difficulties make for needless further delay, it was thought advisable by the Chairman and the undersigned that no more time should be lost in putting this material before the Public. Following this advice, it is now proposed to bring out a complete Series of the National Planning Committee's Sub-Committee Reports, which will

serve as appendices to the Parent Committee's own Report. The Plan of the proposed enterprise is briefly summarised below.

Every Sub-Committee's Report, which is in a final form and on which the National Planning Committee has itself taken resolutions, will be edited and published, with an Introduction assigning their due importance to the suggestions and recommendations contained in that particular report, its proper place in the over-all National Plan; and following it up, wherever necessary, by a kind of Epilogue, summarising the developments that have taken place during the seven years, during which the work of the Planning Committee had been in suspension.

Those Reports, again, which, though in a final form, have not yet been considered, and no resolutions taken thereon, by the Planning Committee, will also be included in the Series in the form in which they were submitted, with such Introduction and Epilogue to each as may be deemed appropriate. And the same treatment will be applied to Reports which are 'Ad Interim', whether or not the Parent Committee has expressed any opinion on the same. They will be finalised, wherever possible, in the office, with such aid as the Chairman or Secretary of the Sub-Committee may be good enough to render. Sub-Committees finally, which have not submitted any Report at all, —they are very few,—will also find their work similarly dealt with. The essence, in fine, of the scheme is that no avoidable delay will now be suffered to keep the National Planning Committee's work from the public.

Both the Introduction and the Epilogue will be supplied by the undersigned, who would naturally be grateful for such help as he may receive from the personnel of each Sub-Committee concerned. The purpose of these additions is, as already stated, to assign its true place to each such work in the over-all Plan; and to bring up the material in each Report to date, wherever possible.

Not every Sub-Committee's Report is sufficiently large to make, more or less, a volume by itself, of uniform size, for this Series. In such cases two or more Reports will be combined, so as to maintain uniformity of size, get-up, and presentation of the material. The various Reports, it may be added, would not be taken in the order of the classification or grouping originally given by the Planning Commit-

tee; nor even of what may be called the intrinsic importance of each subject.

In view of the varying stages at which the several Reports are, for reasons of convenience, it has been thought advisable to take up for printing first those which are final, and on which the Planning Committee has pronounced some resolutions. Printing arrangements have been made with more than one Press, so that two or three Reports may be taken simultaneously and published as soon as possible so that the entire Series may be completed in the course of the year.

Two other Sub-Committees, not included in the list of Sub-Committees given above, were assigned special tasks of (1) preparing the basic ideas of National Planning; and (2) outlining the administrative machinery deemed appropriate for carrying out the Plan. These were unable to function for reasons already explained. The present writer has, however, in his personal capacity, and entirely on his own responsibility, published the "Principles of Planning" which attempt to outline the fundamental aims and ideals of a National Plan. This remains to be considered by the Planning Committee. Similarly, he has also attempted to sketch an administrative machinery and arrangements necessary to give effect to the Plan, when at last it is formulated, and put into execution. Notwithstanding that these two are outside the Scheme outlined in this Preface, they are mentioned to round up the general picture of the arrangements made for publication of the entire work up-to-date of the National Planning Committee and its several Sub-Committees.

The several volumes of Sub-Committee Reports, when published, will be treated as so many appendices to the Report of the parent body, the National Planning Committee. It is impossible to say when that Committee, as a whole, will be able to hold continuous sessions, review and resolve upon Sub-Committee Reports which have not yet been considered, and lay down their basic ideas and governing principles for an all over Plan, applicable to the country, including all the facts of its life, and all items making up the welfare of its people.

The disturbed conditions all over the country, and the Labour unrest that has followed the end of the War has caused unavoidable delays in printing and publishing the

several volumes in the Series, which, it is hoped, will be excused.

In the end, a word of acknowledgment is necessary to put on record the aid received by the Editor in the preparation and publication of this Series. All those who are associated in the task,—members of the Parent Committee, or as Chairmen, Secretaries or Members of the various Sub-Committees,—have laboured wholly, honorarily, and consistently striven to give the best that lay in them for the service of the country. Almost all Provincial Governments and some States,—the latter twice in some cases,—have made contributions towards the expenses of this office, which have been acknowledged and accounted for in the Handbooks of the Planning Committee, published earlier. Suitable appreciation of these will be expressed when the Parent Committee makes its own Report. At almost the end of its task, the expenditure needed to edit, compile, and otherwise prepare for the Press, the several Reports, has been financed by a Loan by Messrs. Tata Sons Ltd., which, even when repaid, will not diminish the value of the timely aid, nor the sense of gratitude felt by the undersigned.

Bombay, 1st July 1947. K. T. Shah.

Note:—In the Scheme of this Series, originally given, more than one Report was intended to be included in one volume in some cases. The combinations indicated in the circular, of the 20th of June 1947, had had to be modified as the printing of several Reports proceeded.

When about half the volumes were printed, it was found that that scheme would not give a fairly uniform series. The new arrangement is given on the page facing the title page. Some changes have had to be made in that list e.g., the separation of the two Reports on Public Health and National Housing, intended to be in one volume, are now in separate volumes.

Conversely, only the two Reports on Animal Husbandry and Dairying and on Fisheries were intended to be combined. As now decided, the Report on Horticulture is also included in the same Volume.

Again, the original combination of the Report on Mining and Metallurgy with that on Engineering Industries has been modified. The latter now combined with the Report on Industries Connected with Scientific Instruments, which was originally meant to be a separate volume, while the former is to be by itself.

31st January, 1948. K. T. S.

CONTENTS

INTRODUCTION

I. Terms of Reference

This Sub-Committee was appointed to deal with:—

(a) banking and currency, including all forms of legal-tender money as well as deposit currency,

(b) the credit system of the country in general,

(c) regulation and control of foreign exchanges,

(d) regulation and control of the country's metallic reserves and other valuta for the service of foreign exchange,

(e) the various types of banking including central banks, industrial banks and commercial banks, co-operative banks, land-mortgage banks, postal banking etc.,

(f) ways and means of mobilising capital within the country and conserving the same for effective employment in the service of the country's agriculture and industry,

(g) saving and investment habits and

(h) measures for linking up rural credit with the capital market.

II. Plan of the Sub-Committee's Report

In amplification of the scope of work of the Sub-Committee on Currency and Banking the following heads of enquiry were laid down by the Sub-Committee, and the work of preparing the memoranda on the several items was distributed among the members named below.

(a)

1.	Forms of Currency and Legal tender Money	Mr. M. Frydman
2.	Standard of Value	" "
3.	Regulation and Control of Foreign Exchanges	Prof. K. T. Shah
4.	Relation of Money and Credit	" "
5.	Pric	"

(b)

6.	Reserve Bank ond Regulation of Banks in India	Mr. M. L. Tannan
7.	Joint Stock Banks	" "
8.	Exchange Banks	" "
9.	Saving and Investment	Prof. K. T. Shah
10.	Savings Banks	" "
11.	Stock Exchange	Prof. C. N. Vakil
12.	Government Borrowing	Mr. M. Subedar
13.	Investment Trusts	" "
14.	Land Mortgage Banks	Prof. C.N. Vakil
15.	Postal Banking	Prof. K. T. Shah
16.	Mobilisation of Capital	Mr. M. Subedar
17.	Linking agriculture and other rural activities with the capital market	Mr. M. Frydman
18.	Conclusion	
19.	Summary	

The work of the Sub-Committee was presented in an Interim Report on which the National Planning Committee took certain resolutions which are given in the text that follows.

In conformity with the general plan of Introduction to these Reports, it is proposed, however, to consider in this introduction the various subjects included in the Terms of Reference from the standpoint of money, currency, legal tender, and banking with reference to their due place in a comprehensive planned National Economy so as to aid the progressive working out of the Plan with the utmost efficiency.

In order, however, to appreciate the several problems of our Currency System today and their solutions in conformity with an all round National Plan, it is necessary to give a brief sketch of the historical development of the Currency System in its several aspects.

III. Evolution of the Present Indian Currency System

The existing currency system of India is the creation, almost entirely, of the British regime in this country. Upto the beginning of the governance of India directly under the British Crown, the Indian monetary system was based on the Silver standard, uniformity of value having been attained by the labours and ordinances of Akbar. With the decline and fall of the Mughal Empire, that unity was lost, and a number of mints as well as standards, sprung up in the country, which made even internal exchange a matter of no mean complexity.

Generally speaking, however, both for internal as well as foreign commerce, the silver Rupee remained the standard, though its weight and fineness varied from State to State, and even within the same State from ruler to ruler. Debasement of currency for the purpose of enriching the ruler was not infrequent; but its virulence was easily discounted by the common practice of large commercial transactions being settled by weight and fineness of the bullion used.

This practice, with all its advantages and disadvantages, was adopted by the East India Company, almost throughout its career in India. As, however, more and more parts of the country came under the dominion of the Company, a uniform coinage—the Company's Rupee,—came to be established; and when paper money was legally authorised to be issued, it was expressed in terms of that standard. The mints of feudatories or allies were either suppressed, or agreed to be closed, the paramount power agreeing to supply all the coinage and currency needs of such States.

A new chapter begins with the discoveries of new sources of gold and silver,—the basis for the currency systems of all civilised countries upto the end of the XIX Century. Unexpected jolts were suffered by the slowly standardising Indian monetary system. The close connection which the East India Company, and, after its abolition, the Government of India had maintained with the British monetary system,—through the former's "Investment" and the latter's "Home Charges",—necessitated a constant attention to the Rupee-Sterling rate of exchange, which eventually proved fatal to the stability of the rupee, and the independence of the Indian currency system.

In the latter half of the last century, more and more European countries began to remodel their currency systems. They were based on gold which was assumed to be an unfailing index of national prosperity. The British currency system had been based on gold as early as 1819 if not a century earlier when Sir Issac Newton was master of the Royal Mint. The continued prosperity of that country, with the lead it had in modern industry and its consequent domination in world commerce, made limitation of the British model irresistible. New gold mines discovered in Australia, Africa, and America added to the quantity of gold in use both for purposes of art and of currency. But this increased quantity was more than absorbed because of the growing volume of international commerce, and the consequent demand for gold in settling the final balance of accounts between nations.

Discoveries of silver on the other hand, which also happened about the middle of the last century, added to the quantities of that metal in circulation, and so contributed to a gradual decline in the gold value of that metal. This was accentuated because of the simultaneous demonetisation of silver over a steadily increasing area in the world of commerce; and the process was completed by the discovery of a new process for producing silver as a by-product from other articles of world trade. The cost of production of that article was more than ever reduced, and the metal became progressively less valuable.

These world factors reacted upon the Indian monetary system under British rule in a steady depression of silver in terms of gold. The Rupee began to lose in value in relation to gold. Thanks to the unceasing demand for gold,—or the pound sterling, which was synonymous for gold throughout the century ending with the World War I,—to pay the "Home Charges" of the Government of India, the exchange value of the rupee sagged progressively. From about 30d to the rupee at the beginning of the last century, it fell to 24d per rupee by the time the East India Company was liquidated, and the Governance of India was transferred to the British Crown direct. Thereafter the process was even more rapid. In the seventies and eighties, the Indian Budget was incessantly thrown out of balance by the falling gold value of the rupee. As the revenues of the Indian Government were collected in rupee, and as a considerable part of its expenditure was in sterling, the problem of conversion always meant a heavy loss, which eventually drove the Government of India frantic. Advice was sought from the one source then thought to be alone competent to advise, however interested, however tainted, it might be. The demands of the rising Indian industry and foreign trade were overlooked. Indian mints were closed to the free coinage of silver rupees in 1893. The rupee thus became scarce, and acquired an artificial value in terms of the pound sterling. The advantage to India's export trade, inherent in the falling exchange value of her standard coin was unappreciated, or deliberately ignored; and our currency system was tied irrevocably for the rest of the duration of the British rule in India, to the vagaries or vicissitudes of the pound sterling.

Under legislation passed in 1899, following the Fowler Committee Report, Government bound themselves to give, at a fixed ratio of 1 rupee=to 16d, any number of pounds for rupees, and vice versa, allowing a margin on either side of a small fraction of a penny considered equal to the cost of im-

port or export of gold into or from India. The coinage of rupees, which was stopped in 1893, was resumed, not as an unrestricted public service at fixed rates, but as a Government monopoly, which yielded a most substantial seigniorage. Thanks to its scarcity, and the growing demand due to the increasing foreign commerce of India, the rupee maintained its artificially enhanced value in exchange. The growing profit of its coinage, was at first kept apart in gold in a special fund called the Gold Reserve Fund, later on amalgamated with the so called Gold Standard Reserve. The gold, however, in this Fund soon disappeared, as it was considered uneconomic to keep locked up such large amounts in idle bullion. The Fund was, consequently, invested in British securities, which made the first beginnings of what we now call **Sterling Balances.** After a first faint attempt, no gold currency was minted in India; and no working Gold Standard established, as recommended by the Fowler Committee. But for these essential omissions, the recommendations of the Fowler Committee were adopted and more or less given effect to as and when it suited Government.

The subsequent fortunes of this Fund, and its counterpart in the Paper Currency Reserve, are unnecessary to detail here, beyond observing that they scarcely ever fulfilled the declared purpose of their original institution. At the first touch of a crisis, for instance, in 1907, Government disowned their obligation to give gold for silver rupees and vice versa. The years of World War I confirmed the worst apprehensions of the Indian critics of this managed currency system, christened specifically into Gold Exchange Standard by the fertile imagination and facile pen of the late Lord Keynes.

World War I saw the beginnings, also, of what is now called Inflation. It came about for the same reasons, showed the same symptoms, and called out the same nostrums from the same type of quacks called in to treat the malady. The Note Issue was inflated to three times the maximum circulation before the War, mainly because of the Indian Government's commitments on account of the British during the War. An unprecedented,—perhaps illegal gift of a £100 million, later raised to £ 130 million—did not suffice to draw out the new purchasing power from the people's hands, notwithstanding recourse to Treasury Bills and heavy public borrowing at high rates of interest.

Gold had long since disappeared from our currency system, and rupee coinage was no longer profitable. This was not a situation to the advantage of British bankers or brokers, who had reaped a rich harvest from the silver purchases of the

Government of India, and unlimitated sales of the Council Bills to pay the Home Charges. They accordingly recommended, in the guise of the Report of the Babington—Smith Commission, a two-shillings rupee, in the hope that, with that artificial appreciation of the Indian standard(?), British goods would find an easier market in this country, and so aid in the post-war recovery of that country. But after less than a year's disastrous experiment, which wiped off all the accumulated profit of years of silver coinage, and involved a loss of 35 crores to the Indian Exchequer, Government retired from the business confessing their failure and admitting the losses. Perhaps no other chapter in the currency history of India is sadder or costlier.

In the years after 1920, the rupee seemed to have regained its more customary level in exchange, Re. 1=16d. This, however, did not quite suit the British exporter to India, especially in the face of the new fiscal policy, which had accepted the principle of fiscal protection to Indian Industry. A new Commission was, therefore, constituted,—fifth in 30 years, —presided over by Hilton-Young; and on its recommendations the foundations were laid of what may be called the present currency system.

IV. Metallic Currency Since 1927

The Indian Currency Act of 1927 established the new ratio of 18d=1 Re. (gold) and provided that Government would purchase gold at a price of Rs. 21-3-10 per tola of fine gold in bars of not less than 40 tolas each; and would sell gold, or, at their option, sterling, for immediate delivery in London, at the same price, after allowing for the normal cost of transport from Bombay to London. A rate of 1sh. 5-49/64 was notified as Government gold (or rather sterling) selling rate; but within four years of the legislation, Britain herself having gone off gold, the new Act became a dead letter so far as gold sales were concerned.

This was an act of perfidy, which, though not without plenty of precedents in the Currency History of India, was unique of its kind in international dealings, particularly by a country which had prided itself on its being the world's only free gold market; and where, therefore, on the strength of such pretensions, other countries were accustomed to keep handsome balances to settle their own accounts in international trade. With the break with gold in Britain, India had to toe the line. Gold began to be purchased, not at the fixed, but at a steadily mounting rate in India and was exported to

bolster up the tottering pound. The Table appended shows what amounts of gold left India during the Depression Decade commencing with 1930.

It cannot be repeated too often that this was due mainly, if not entirely, to the rupee being tied to the pound sterling, which has never been synonymous with gold in the last generation. Had the rupee been dislinked from the pound, and left free to shape its own course it is possible the initial shock of World Depression would have reduced its value in dollar or gold. But the intrinsic strength of the Indian export market, further stimulated as it must be by a substantial fall in exchange, would have soon asserted itself. And had those who had the management of the Currency System in their hands sought to promote the interests of this country only, and conserved the balance of payment received in international settlement of accounts into substantial reserve, gold, instead of flowing out of the country, would in all probability have flowed in, and so provided a more dependable backing for our currency system during the next crisis which came with World War II. The Table showing imports and exports of Gold, including Sovereigns, and Silver, since the commencement of the century, tell their own tale in corroboration of the argument advanced above. (Table on pp. 24-25.)

V. Paper Money—Note Issue

Hitherto only the metallic portion of the currency system has been considered. Paper money or Currecy Note circulation is however much more important, both in volume and in its reaction upon the aggregate national economy. It is the most easily affected item in the regulation of the price-level, and is the main source of inflationary and deflationary trends. Its place in the present structure in India's national economy must, accordingly be studied with some care. All the theories about money elaborated by classical economists revolve round this most considerable portion of a country's currency system, especially in a country where deposit currency by cheques is not very common.

Paper money began in India in the middle of the last century. Several banks issued Notes, each on its own responsibility. Wiser, however, by the experience of such banknotes in England, the Note Issue was vested and concentrated in 1861 in the three Presidency Banks of Bombay, Calcutta and Madras. These were private Institutions, no doubt; but in consideration of this great privilege of becoming the only channels for the issue of legal tender Currency Notes, they

TABLE I

Value of Imports and Exports of Gold Coin and Bullion and Silver* (India and Burma) Since 1900-01

(Figures are in Crores of Rupees)

	Total Imports of Gold.	Total Exports of Gold.	Net Imports (+) or Exports (—) of Gold.	Total Imports of Silver.	Total Exports of Silver.	Net Imports (+) or Exports (—) of Silver.	Total Imports of Gold, Bullion and Silver.	Total Exports of Gold, Bullion and Silver.	Total Imports(+) or Exports (—) of Gold, Bullion and Silver.
Average for									
1900-01 to 1904-05	15.0	8.8	+ 6.2	14.6	4.5	+ 10.1	29.6	13.3	+ 16.3
1905-06 to 1909-10	17.4	5.7	+ 11.7	17.7	2.3	+ 15.4	35.1	8.0	+ 27.1
1910-11 to 1914-15	29.9	4.5	+ 24.3	14.1	3.5	+ 10.6	44.0	8.0	+ 34.9
1915-16 to 1919-20	19.6	6.2	+ 13.4	30.7	2.7	+ 27.9	50.3	8.9	+ 41.3
1920-21 to 1924-25	36.4	7.7	+ 28.7	19.1	3.4	+ 15.7	55.5	11.1	+ 44.4
1925-26 to 1929-30	21.6	0.1	+ 21.5	17.4	3.6	+ 13.8	39.0	3.7	+ 35.3
1930-31	13.2	0.4	+ 12.7	13.4	3.3	+ 10.0	26.6	3.7	+ 22.7
1931-32	2.7	60.7	— 57.9	4.4	4.8	— 0.4	7.1	65.5	— 58.3
1932-33	1.3	66.8	— 65.5	1.6	3.6	— 2.0	2.9	70.4	— 67.5
1933-34	1.0	58.1	— 57.0	0.8	7.1	— 6.3	1.8	65.2	— 63.3
1934-35	0.7	53.2	— 52.5	4.4	9.8	— 5.4	5.1	63.0	— 57.9
1935-36	0.9	38.3	— 37.3	6.4	9.0	— 0.5	7.3	47.3	— 37.8

1936-37	1.6	29.4	— 27.8	13.8	0.2	+ 13.5	15.4	29.6	— 14.3
1937-38	1.5	17.9	— 16.3	2.5	0.9	+ 1.5	4.0	18.8	— 14.8
1938-39	0.7	13.7	— 23.2***	1.5	0.9	+ 0.5	2.2	14.6	— 22.7
1939-40	0.7	37.2	— 44.6@	4.1	2.6	+ 1.4	4.8	39.8	— 43.2
1940-41	..	12.8	— 12.8	1.4	3.4	— 2.0	1.4	16.2	— 14.8
1941-42	..	2.1	— 2.1	3.7	9.2	— 5.4	3.7	11.3	— 7.5
1942-43	..	0.4	— 0.4	0.28	8.5	— 8.2	0.2	0.9	— 8.6
1943-44	0.3	0.2	+ 0.1	3.9	1.7	+ 2.2	4.2	1.9	+ 2.3
1944-45	0.1	..	..	22.6	0.4	+ 22.3	22.7	0.4	+ 22.3
1945-46	0.2	0.4	— 0.2	8.0	0.1	+ 7.9	8.2	0.5	+ 7.7
1946-47	8.1	1.5	+ 6.6	24.2	..	+ 24.2	32.3	1.5	+ 30.8
1947-48 .. .. (Nine months ended December 1947)**	8.6	..	+ 8.6	10.1	..	+ 10.1	18.7	..	+ 18.7
Total for 31 years from 1900-01 to 1930-31	714.5	166.7	+547.7	583.1	104.4	+478.7	1297.6	271.1	+1026.4
Total for 16 years from 1931-32 to 1946-47	20.5	393.6	—373.0†	104.1	60.8	+ 43.3	124.6	454.4	—329.7
Net Total from 1900-01 to 1946-47			+174.7			+522.0			+696.7

* Government of India Rupees are shown at face value.
** Provisional figures. Excluding figures for imports to and exports from the port of Karachi from October 1947.
*** Including 1,030,420 ounces of gold valued at Rs. 10,19 lakhs earmarked on account of purchases abroad.
@ Including 788,947 ounces of gold valued at Rs. 8,08,08,376 earmarked on account of purchases abroad.
† Including 1,819,367 ounces of gold valued at Rs. 18,27,08,376 earmarked on account of purchases abroad.
Since 1941-42 figures are on post-separation basis.

Source:—Statements VIII and IX from the Report on Currency and Finance for the year 1947-48 issued by the Reserve Bank of India.

agreed to certain conditions and regulations imposed upon them by the Act.

The total Note Issue in the commencement was little more than Rs. 10 crores, of which Rs. 4 crores, was supposed to be covered by securities of the Indian Government, and the balance by rupees or silver in full equivalence. The Notes were encashable on demand into rupees; but those issued by one circle, were not as a matter of right, encashable in another circle. This unavoidably impeded the popularity of the Notes which were the liability of the Government of India.

With the difficulties, however, that the Government of India experienced in regard to the last quarter of the XIX century in connection with Silver Rupee, and the changes which were made in the last decade this paper money assumed much greater importance. Both the coined rupee and the currency note were taken from and after 1900, the former printed on silver, and the latter on paper. Both were supposed to be convertible on demand into gold. But when the first considerable demand for such conversion was impending, the Government of India promptly disowned their obligation. Facilities were afforded for their encashment as between the different circles of issue; and conversion into metallic money, silver, or after 1900, gold, at a fixed rate was for a while also encouraged. But this was a relatively shortlived opportunity which was practically gone after 1914.

Before the beginning of World War I, the Note Circulation had reached the neighbourhood of Rs. 70 crores. Its convertibility was ensured by an equivalent Reserve, held partly in silver, coin or bullion, gold, coin or bullion, rupee securities of the Government of India and sterling securities, which occasioned considerable difficulties. The amount of the fiduciary portion of the Reserve was fixed absolutely. Of the metallic portion, silver, coin or bullion was held largely in India, while gold, coin or bullion, was held partly in India and partly in Britain.

The Paper Currency Reserve was regarded primarily to be a backing for conversion of the Notes, while the Gold Standard Reserve, built up out of the profits of Rupee coinage since 1899, referred to above, was intended for the conversion of Silver Rupees into Gold, or Sovereigns while they circulated. In practice, however, the two Reserves were closely interlocked and inter-changeable, particularly after a part of the G.S.R. came to be invested in Sterling Securities. In the event of any sudden demand for remittance from India, the Gold in the Paper Currency Reserve was first utilised, and

replaced when the demand had eased off, or by sale of securities and transfers from the Gold Standard Reserve. The rigidity of the Paper Money was slightly relaxed in the twenties. The Act was modified to permit an additional issue of Notes, uncovered by metallic or securities reserves, but covered by commercial bills of exchange, of an equal amount, subject to certain conditions about the rise in the bank rate. This permitted seasonal variations within fixed limits. When trade demand fell off the commercial bills would be paid up, and the notes issued against them automatically cancelled. It was, however, not sufficient to make the Note Issue, or the entire currency system as elastic in response to varying Trade demand as could be desired. The changes proposed by the Royal Commission while recasting the Note Issue in the Reserve Bank were meant to meet that difficulty.

A Royal Commission on Indian Currency and Finance (1926) held that the legal obligation to **convert Notes into Rupees** at any time must remain, though the conversion into gold was not insisted upon by that body, in marked contrast with the corresponding recommendation of the Fowler Committee in 1899. The new Notes, which the 1925 Commission proposed were to be issued by a Central Bank, eventually realised in the present Reserve Bank of India, need not be subject to such obligation of conversion into metallic money, but only into legal tender money, which might be notes of smaller denominations, or silver rupees at the option of the issuing authority. This tended to weaken the public confidence in these Notes,—though the events which followed the Commission's recommendations prevented any test being applied to this part.

The obligation was also to be imposed upon the Central Bank to provide Foreign Exchange; and as Sterling was then regarded as equivalent to Gold, this obligation in practice became identical with providing Sterling Exchange, even though Sterling had parted company with gold in 1931.

It must be added, however, that the Royal Commission referred to did not speak of Foreign Exchange being equivalent to Sterling only. Their actual words were "the obligation is to convert the Currency, not merely into Foreign Exchange, but into **Metallic Gold**; and it is an obligation that is not, as formerly, conditional and circumscribed, but absolute and unlimited. It has been undertaken by every other country that has adopted an effective Gold Standard, and we have satisfied ourselves that the present resources in the form of reserves at the disposal of the Government of India are adequate to enable the Currency Authority safely to undertake

TABLE II.

Note Issue and Circulation

Statement of the Affairs of the Reserve Bank of India.

(In lakhs of rupees)

	LIABILITIES.			ASSETS.				
Average of Friday Figures.	Notes in Circulation.	Notes held in the Banking Dept.	Total Liabilities (Total Notes Issued) or Assets.	Gold Coin and †Bullion.	Sterling Securities.	Rupee Coin*	Rupee Securities.	Percentage of Gold and Sterling Securities to Total Notes Issued.
1935-36	164,06	27,58	191,64	44,42	62,09	55,51	29,62	55,58
1936-37	175,81	25,81	201,62	44,42	69,57	64,01	23,62	56,54
1937-38	186,15	25,61	211,76	44,42	79,92	60,23	27,19	58,72
1938-39	182,36	28,28	210,64	44,42	66,95	67,11	32,16	52,91
	(7,97)	(1)	(7,98)					
1939-40	209,22	18.79	228,01	44,42	78,63	67,52	37,44	53,97
	(11,09)	(8)	(11,17)					
1940-41	241,41	17,26	258,67	44,42	129,92	35,87	48,46	67,39
	(13,38)	(20)	(13,58)					
1941-42	307,68	12,21	319,89	44,42	165,00	35,28	75,19	65,47
	(20,20)	(23)	(20,43)					
1942-43	513,44	11,80	525,24	44,42	319,11	22,33	139,38	69,21
1943-44	777,17	10,50	787,67	44,42	643,52	14,28	85,45	87,34
1944-45	968,69	10,93	979,62	44,42	863,73	13,52	57,95	92,70
1945-46	1,162,64	16,41	1,179.05	44,42	1,061,26	15,53	57,84	93,78
1946-47	1,222,96	32,61	1,255,57	44,42	1,133,88	19,43	57,84	93,85
1947-48	1,227,82	47,12	1,274,95	44,42	1,135,32	32,36	62,84	92,53

Figures for Burma shown within brackets below totals; figures for India only from June, 1942.

† Valued at the statutory rate of Rs. 21-3-10 per tola.

* Including Government of India one rupee notes from July, 1940.

Source:—Statement XL from the Report on Currency and Finance for the year 1947-48 issued by the Reserve Bank of India.

The total gross circulation of Notes in March 1948 had reached Rs. 1316.68 (cp. Statement XL from the Report on Currency and Finance 1947-48. p. 176.

the obligation with the measures of fortification at the time which we specify".

After the end of World War I, the three Presidency Banks were amalgamated into one Bank, the Imperial Bank of India, and the Note was then transferred for management to that new Institution. The Notes, however, still remained the liability of the Government of India and Note of the Bank. This, however, was changed when the Reserve Bank of India was established in 1935, as recommended by the Commission. The provisions of the convertibility and reserve against the Paper Money have been outlined in another section. The table II on page 28 gives the growth in the Note Issue and the composition of the Reserve against it from the foundation of the Reserve Bank to date.

Recommendations for Currency Reform by the Hilton-Young Commission

Let us now summarise the recommendations of the Royal Commission of 1925-26.

They considered that the ordinary medium of circulation should remain the currency note, and the silver rupee, and that the stability of the currency in terms of gold should be secured by making it directly convertible into gold. Unlike the Fowler Commission, however, they were against a free gold mint in India, as well as gold coinage in circulation. The sovereign and half-sovereign, till then legal tender, were to cease to be so. They suggested the Currency Notes—issued by a Central Bank—to be full Legal Tender.

The need for unity of policy to control currency and credit for achieving monetary stability required institution of a Central Bank in charge of both. This materialised later on as the Reserve Bank of India.

The Paper Currency should cease to be convertible by law into gold or silver coin. But the issuing Bank must maintain free inter-changeability of the different forms of legal tender currency; and Government must supply the necessary coins to the Bank on demand. For this purpose one-rupee notes should be re-introduced and should be full legal tender.

Notes other than those for one-rupee should be by law convertible into legal tender money, i.e. into notes of smaller denomination or silver rupees, at the option of the currency authority.

The Paper Currency Reserve, and Gold Standard Reserve should be amalgamated, and the proportions and composition

TABLE III

Total Money Supply in India and Pakistan

(In crores of rupees)

	March 1942†	March 1943	March. 1944	March. 1945	March. 1946	March. 1947	March. 1948
Notes in Circulation	382	644	882	1,085	1,219	1,242	1,304
Demand deposits of banks (scheduled and non-scheduled)**	232	387	543	624	735	711	762
Deposits with the Reserve Bank of India (excluding deposits of Burma Govt.)	63	87	167	392	643	562	457
Cash reserves of banks (scheduled and non-scheduled)**	54	65	78	120	120	116	121
Money Supply excluding rupee coin and small coin (1 plus 2 plus 3 minus 4)	623	1,053	1,514	1,981	2,477	2,399	2,402
Circulation of rupee coin		124@	137	147	166	168	155
Total Money Supply (excluding small coin) (5 plus 6)		1,177	1,651	2,128	2,643	2,567	2,557
Increase in Money Supply (excluding rupee coin and small coin)	191	430	461	467	496	—78	3
Percentage rate of increase	44.2	69.0	43.8	30.8	25.0	— 3.1	0.1

Items 1-7 figures as on last Friday. @ October 1943. **For some periods figures relating to non-scheduled banks are estimates, while figures since the partition are generally for India only. †Increases over the previous year.

Source:—Table 27, from the Report on Currency and Finance for the year 1947-48 issued by the Reserve Bank of India.

of the combined Reserve should be fixed by Statute. This is given later on while describing the constitution and functions of the Reserve Bank, the proposed Central Bank for issuing Currency Notes.

The Table on page 30 gives a picture of the total amount of Money of all kinds in circulation, and its growth since 1942-43 when Inflation began on a large scale. It includes deposits at call in all Banks, as well as Currency Notes and Rupee Coins in circulation. Fixed deposits—on which cheque currency cannot be developed, and small coins are not included.

VI. Peculiarities of the Indian Currency System

Having reviewed both the metallic and the paper portion of our currency system, some of its peculiar features may now be summed up.

As already pointed out, there is no standard of money, and, therefore, no definite objective norm or measure by which changes in values or developments in the National Economy can be gauged. The various Commissions and Committees have, from time to time, made simple or sophisticated suggestions for introducing the Gold Standard in one form or another. But the exigencies of British Imperialism prevented their recommendations materialising, or being given effect to in the spirit in which they were made.

The rupee itself, though still in circulation, is not a standard coin. It is only a fraction of the pound sterling; and the only guarantee of its stability in that regard is the statutory obligation placed upon the Reserve Bank of India to maintain a fixed rate of exchange with the pound sterling. As the latter itself is a varying quantity, however, since its going off gold in the Summer of 1931; and as its variations, particularly during the War, have been substantial, the fixity of the Rupee Setrling ratio is, by itself, no real guarantee of the stability of the Indian currency system.

The pound sterling, it may be added, has been maintained at a fixed ratio to the dollar, by agreement with the war-time ally—the United States. But even the dollar has depreciated 40% since 1933, so that the pound sterling has depreciated, in the terms of the dollar, from $4.87 = £1. to $4.05 = £1. In reality, therefore, the pound is worth, in terms of the 1930 price level, somewhere about 3/8ths, if not less than its original gold value.

Nowhere, however, in the world of Commerce today, is there anything like a real gold standard as it had functioned

in Britain between 1819 and 1914. There is no stable standard money either. It may, therefore, not be regarded as a feature peculiar to the Indian Currency System. But whereas in other countries there is a tendency to work back to a previous norm or standard, however impossible that norm may seem to be to attain, in India there is no such norm, and has never been during the last 100 odd years. There is, therefore, no fixed goal to be realised. The Rupee, if it is to have anything like a standard place in International Exchange, must, first of all, be dislinked and separated completely from the pound sterling, and emancipated from all the complications or vicissitudes that hang around the pound sterling. The inherent strength of India's National Economy would then gradually assert itself. And if the country's currency system, both metallic and paper money, is properly managed, in the interests of this country and its planned economy, it is not at all improbable that the rupee will regain the position it had in the last century, as something definite and capable of a fixed value in exchange that can be easily maintained. India is today a creditor country, though her dues are not likely to be realised in the near future. She has no longer a heavy burden of "Home Charges" to meet allround. And though she is, for the moment, obliged to import heavily food and capital goods, if the plans now laid are achieved, she would soon show an export surplus which would add further strength to her standard of currency. It would once again restore the inward flow of specie, and facilitate her maintenance of a stable ratio in exchange without any detriment to her own interests in trade or industry.

The subsidiary coinage in circulation in India has not been considered in this review, not because it does not exist, but because it is relatively unimportant. The rupee itself has been debased till its silver content is hardly half of what it used to be. Silver has risen four or five times its pre-war value. The old time possibility of deriving any profit from the coinage of rupees or subsidiary silver coins no longer exists. For sentimental reasons it may be that India will continue to use rupees in large quantities in daily transactions. But, as a fuller knowledge of the place of metallic or representative money in a progressive economy spreads amongst the people, and as the suspicion which used to haunt them before the War of the manipulation of the rupee for the benefit of Non-Indian interests disappears, the use of paper substitutes for metallic money, and still more of bank deposits in the shape of cheque currency, would become more and more popular. Further, if banking facilities within the country, widen and deepen, as suggested hereafter, so as to meet the peculiar

requirements of this country, the use of metallic money, and all the waste of capital locked up in reserve to maintain convertibility of the Paper Currency, that such use may involve, would be progressively avoided.

In regard to the Paper Money or Currency Notes in circulation, apart from the lack of a fixed standard of value in terms of which currency notes are expressed, there are two glaring difficulties which must be mentioned at this stage. These are unlimited legal tender but convertible only in legal tender, and not in gold or silver. This is a great weakness, especially among a people ruled by aliens, and suffering from suspicion of being exploited for foreign benefit. The dependence upon Sterling of the currency note for convertibility in the shape of sterling securities, is another, and utterly unnecessary source of weakness. It provides no greater safety for the Indian Paper Money to the extent that it is covered by Sterling Securities. On the contrary, it is a source of weakness because of the likely vicissitudes of the pound sterling itself arising out of economic as well as political factors. At the present time more than half the total issue is covered only by the sterling securities, which are for all practical purposes unrealisable; and therefore the notes backed by them inconvertible.

Apart from this, the monetary system in India has all along been lacking in the degree of elasticity, which provides for automatic expansion or contraction in accordance with the varying needs of trade, and of a growing economy. Rupees, once put into circulation, do not return automatically when the need for them is over. They used to be an excellent means of hoarding, in the shape of silver ornaments, which could be liquidated only in times of severe distress when circulation would need to be contracted, not expanded. If, on the other hand, more rupees were needed for circulation, they could only come from new minting of silver which would have to be imported from abroad. This would needlessly affect our trade balance. And as for Paper Money, since beyond a certain figure, additional Notes could only be put into circulation by providing more gold or rupees in the Reserve, or adding to the volume of rupee or sterling securities, these would be no expansion in response to genuine trade demand; but only a means to inflation. Contraction, on the other hand, of this currency has never happened on a large scale; and will not happen in the future unless and until the Note Issue is linked directly with the country's productive organisation and distribution arrangements.

TABLE IV

Total Amount of Cheques cleared since 1919-20

(In lakhs of Rupees)

Year	Bombay	Calcutta	Delhi	Kanpur	Karachi	Lahore	Madras	Total
1919-20	8,83,02	10,55,76	—	—	23,13	—	33,95	19,95,86
1924-25	6,21,66	9,54,11	—	5,72	46,13	5,57	55,96	16,89,15
1929-30	7,93,66	9,60,97	—	7,56	26,49	8,17	82,19	18,79,04
1934-35	6,89,17	8,75,69	—	11,51	28,96	10,43	56,22	16,71,98
1939-40	8,83,97	11,54,03	20,35	14,22	37,53	11,14	99,94	22,52,91
1940-41	8,02,32	10,08,53	28,53	19,20	46,76	16,33	1,08,65	20,72,60
1941-42	10,48,60	12,33,61	41,35	29,59	58,80	26,71	1,36,41	26,66,34
1942-43	13,45,23	10,74,66	81,94	56,21	77,51	48,76	1,31,40	29,79,09
1943-44	19,66,69	17,18,61	1,19,16	1,01,06	1,01,36	77,80	1,96,80	45,79,22
1944-45	22,36,97	23,51,59	1,29,94	1,12,95	1,24,54	95,94	2,27,37	56,26,80
1945-46	24,87,60	28,26,21	1,46,02	1,13,47	1,45,49	1,03,39	2,98,23	65,72,37
1946-47	28,59,08	28,42,25	1,56,37	1,42,66	2,01,82	1,36,92	3,78,00	72,21,38
1947-48	24,52,64	25,99,96	1,26,46	1,09,83	2,74,81	49,54	3,47,94	64,80,14

Contrary to the trend noticed since 1940-41, the total amount of cheques cleared showed a steep fall during the year from Rs. 7,221.38 crores in 1946-47 to Rs. 6,480.14 crores in 1947-48. The heaviest fall in total clearings was registered at Bombay.

Sourse: Report on Currency and Finance p. 166, 1947-48.

Note: The total for the years 1939-40—1947-48, also includes the figures for other centres.

Reference has been made in the preceding review to a provision introduced in the twenties for linking a fraction of the Paper Currency with the seasonal expansion of trade demand for money. That, however, related to a very small fraction of the total Note circulation. It was, besides, subject to a maximum of Rs. 12 crores, about 5% of the total circulation as well as conditioned in other ways. All that did not make for a real elasticity in the monetary system. Paper Money would be unable to render its full service to the country's economy, so long as the reserve provisions are rigid as today, with sterling securities predominating; and so long as a close contact with the active features of the country's economy, particularly in regard to domestic and foreign trade, is not provided.

There is, next, no co-ordination between the total value of money of all kinds in circulation and the aggregate national economy. There is very little of the so-called "deposit currency", which every modern commercial country tends to develop more and more. It is the one element likely to expand or contract in accordance with the general trade needs.

Statistics of the Clearing House in India suggest relatively small proportion of the domestic trade of the country being settled by means of cheques or bills. (Refer to Table IV on page 34.)
But even so it seems to be far more considerable than the paper and metallic money put together. If the metallic portion of the currency is to be economised, and if the entire monetary system is to be made to function as integral part of the aggregate National Plan, it is of the utmost importance that habits and facilities of banking, and therefore the use of deposit currency, be encouraged to the utmost possible.

There is, moreover, no correlation, consciously devised and maintained between the total volume of money in circulation,—whether metallic or otherwise, and the economic needs of the country, its productive capacity, or distribution requirements. At the present price-level, notwithstanding a fall in the quantum of production, in agriculture as well as industry, the total wealth annually produced in the country may well be put at something over Rs. 6,000 crores for the Indian Union. If this volume of goods is to be exchanged only once, from the producer direct to the consumer, without any intermediary, the total money needed would be a corresponding figure, with due allowance for the rapidity of circulation, and the use of substitute forms devised. The present volume of production is, however, expected to increase, especially if a planned programme of progressive development takes effect. The volume of money—or the medium of exchange—needed would be

somewhere about Rs. 3,000 crores, if we allow for 3 intermediaries of the village trader, the wholesale merchant or exporter, and the final consumer; and each money unit to do the work of ten by its velocity of circulation. India, however, does not produce her own requirements of gold (except in negligible proportions) or silver within the country. Our present total circulation may be taken to be Rs. 2,500 crores in all forms of money. But that is said to have caused severe inflation. If that cry is to be avoided, our monetary system will have to be so devised as to be not only in clear co-relation with the total value of wealth to be exchanged, making allowance for the various intermediaries and rapidity of circulation; but also the facilities for substitute monies in the shape of Bank cheques or deposit currency, or other means that may be devised.

It would be futile to lay down any definite formula for calculating the total volume of money or currency needed by India. It is, however, important to emphasise this point, as in planned economy it would be impossible to leave the working of the Price Mechanism to function as erratically and unco-ordinatedly as it has been doing under the present system of ad hoc regulation or chaotic laissez-faire. The price mechanism is, in the ultimate analysis, only a means to effect exchange between producer and consumer, or rather secure adequate and regular distribution of the means of satisfying the wants of man, provide for all the services, amenities and utilities which go to make up the modern living standard in a modern civilised country, and maintain in smooth working order the entire productive organisation. Viewed thus, there is no sanctity in the price level prevailing at any given moment. It may be fixed at any point that the exigencies of the country's economy may demand. The factors causing variations will be more than neutralised, if the changes in the price-level are made exclusively in response to the needs of the local economy, and not dictated by any extraneous factors.

VII. Banking and Credit

Mention has been made in an earlier section of the need to co-relate Banking Currency with the Metallic or Paper Currency used in this country. The Development and working of Banks and Banking must, therefore, next claim our attention.

Banking in all its variety seems to have been known and practised in India from time immemorial. In the modern form, however, in which that occupation is most commonly under-

stood today, it may be said to have begun in the last century under the influence of the foreign trading corporations, which were by that time asserting themselves in the economic life of the country. Financing of trade was the principal urge for developing modern type of commercial banking. Various types of banks and banking business have been developed since then in this country, into the details of which it is unnecessary to go. The principal types that dominate, so to say, the banking business of the country today are:—

(1) The Reserve Bank of India—a Central Statutory Corporation for the management of the country's credit and currency.

(2) The Imperial Bank of India, another National institution, with a special Charter or Statute of its own.

(3) Exchange Banks, mostly of non-Indian registration.

(4) Indian Joint Stock Banks (Scheduled Banks).

(5) Indigenous Bankers, Shroffs, or Money-lenders.

(6) Co-operative Credit Societies (mainly agricultural).

(7) Land Mortgage Banks.

(8) Industrial Finance Corporation.

(1) Reserve Bank of India

The Reserve Bank of India is, historically speaking, the last link in the chain; but it stands at the very apex as the Central Monetary and Credit Organisation of the country.

A Bill to establish a Reserve Bank in India, as an essential preliminary to the introduction of the scheme of Reforms recommended by the Currency Commission, was first introduced in the Indian Legislature in 1927; but owing to opposition of vested interests, it was dropped at the time. The proposal remained in cold storage for seven years, at the end of which it was again brought forth. But by this time, its complexion had slightly changed. From being conceived as a purely Central Currency and Credit Organisation of the country, it had become a preliminary essential to the introduction of Provincial Autonomy and Federal system of Government in India. Being conceived as a sort of bulwark against any hare-brained schemes of currency reform by any Government falling into the hands of irresponsible nationalists (?), and being taken to be a guarantee for the vested interests against any proposals for repudiation or cancellation of the Public Debt,—as was feared to be the Congress intentions,—the Bank was made an independent, Statutory Corporation, owned by

private shareholders, but controlled by Government in the public interest. The Legislature passed that Bill, which received the assent of the Governor-General on March 6th, 1934.

The main purposes for which the Bank was constituted were:—

(a) taking over the management of the Currency System of the land from the Governor-General-in-Council; and

(b) of carrying on the business of banking for Government as well as for the country collectively.

The original share capital of the Bank was Rs. 5 crores divided into shares of Rs. 100 each, all fully paid-up. To guard against undue concentration of voting power, in any one hand, the maximum number of votes any one shareholder could have was restricted to 10, every five shares carrying the right of one vote. The entire capital is owned by private shareholders, except the small amount reserved by Government to be disposed of at par to a Director of the Central Board, if required for qualifying to become a Director.

Five Share Registers were to be maintained at Bombay, Calcutta, Delhi, Madras and Rangoon, and the nominal value of the shares assigned to each centre was fixed at Rs. 140 lacs for Bombay, Rs. 145 lacs for Calcutta, Rs. 115 lacs for Delhi, Rs. 70 lacs for Madras and Rs. 30 lacs for Rangoon. Since the separation of Burma, Rangoon is eliminated.

No person can be registered as a shareholder who is not:—

(a) domiciled in India or Burma and either an Indian or Burman subject of His Majesty; or a subject of a State in India or Burma, or

(b) a British subject ordinarily resident in India or Burma, and domiciled in the United Kingdom, or in any part of His Majesty's Dominions, the Government of which does not discriminate in any way against Indian or Burman subjects of His Majesty; or

(c) a company registered under the Indian Companies Act 1913, or a society registered under the Co-operative Societies Act; or a Scheduled Bank or a Corporation or a company incorporated by or under an Act of Parliament or any law for the time being in force in any part of His Majesty's Dominions, the Government of which does not discriminate in any way

against Indian or Burman subjects of His Majesty and having a branch in British India or in Burma.

Since the separation of Burma in 1937, consequential modifications have been made in this section of the Act.

At a general meeting of the Bank or at an election of members of a Local Board, each shareholder has one vote for each five shares held by him subject to a maximum of ten votes.

The share capital of the Bank may be increased or reduced on the recommendation of the Central Board, with the previous sanction of the Central Government and with the approval of the Central Legislature.

After making provision for bad and doubtful debts, depreciation in assets, contributions to staff and superannuation funds, and such other contingencies as are usually provided for by bankers, and after payment out of the net annual profits of a cumulative dividend at such rate, not exceeding five per cent per annum, as the Central Government may fix at the time of the issue of shares, a portion of the surplus is allocated to the payment of an additional dividend as prescribed by the fourth schedule. The balance of the surplus is paid to the Central Government. If, however, at any time, the reserve fund is less than the share capital, not less than Rupees fifty lakhs of the surplus, or the whole of the surplus, if less than that amount, must be allocated to the reserve fund.

Management of the Bank.

The general superintendence and direction of the Bank is entrusted to a Central Board of Directors consisting of 16 members, namely:—

(a) a Governor and two Deputy Governors appointed by the Central Government after consideration of the recommendations made by the Board in that behalf;

(b) four Directors nominated by the Central Government;

(c) eight Directors elected on behalf of the shareholders on the various registers mentioned above. Two Directors each are elected for the Bombay, Calcutta and the Delhi registers and one each for the Madras and the Rangoon registers, and

(d) one Government Official nominated by the Central Government.

For each of these five areas there is a Local Board consisting of:—

(a) five members elected from amongst themselves by the shareholders who are registered on the register for that area and are qualified to vote, and

(b) not more than three members nominated by the Central Board from amongst the shareholders registered on the register for that area.

The Governor and Deputy Governors are executive heads, holding office for a term, not exceeding five years. They are eligible for re-appointment.

Business Open to the Bank

The Bank is authorised to carry on and transact the following commercial business, viz:—

I. (a) accepting of money on deposit without interest,

(b) purchase, sale and re-discount of bills of exchange and promissory notes with certain restrictions,

(c) making of loans and advances, repayable on demand, but not exceeding 90 days, against the security of stocks, funds and securities other than immovable property, against gold coin or bullion, or documents of title to the same, and such bills of exchange and promissory notes as are eligible for purchase or rediscount by the Bank,

(d) purchase from and sale to scheduled banks, of sterling in amounts of not less than the equivalent of Rs. 1 lakh,

(e) making of advances to the Central and Local Governments, repayable in each case not later than three months from the date of the advance,

(f) purchase and sale of Government securities of the United Kingdom maturing within ten years from the date of purchase,

(g) purchase and sale of securities of the Government of India, or of a Local Government, of any maturity or of a Local Authority in British India, or of certain States in India which may be specified.

Government's Agency Business

II. The Bank must act as Agent for the Government of India or any Local Government or State in India for the:—

(a) purchase and sale of gold and silver,

(b) purchase, sale, transfer and custody of bills of exchange, securities or shares,
(c) collection of the proceeds, whether principal, interest or dividends, of any securities or shares,
(d) remittance of such proceeds by bill of exchange payable either in India or elsewhere, and
(e) management of public debt.

The Bank accepts monies for account of the Central and Local Governments, and carries out their exchange, remittance, and other banking operations. It manages the Public Debt on such conditions as may be agreed upon. For the management of the Public Debt the Bank is paid a Commission of Rs. 2,000/- per annum for every Rs. 1 crore of Debt.

The Law requires the Bank to sell sterling at a rate not below 1sh. 5.49/64d. and buy sterling at a rate not more than 1sh. 6.3/16d. per rupee. It is thus obliged to maintain the fixed rupee-sterling ratio. This is, however, not quite what the Commission had recommended, as sterling is not gold, nor nowadays convertible into gold freely. It is, in fact, this provision which has been abused to lock up such huge resources of India into the practically unrealisable Sterling Balances of the War-time growth.

It may be added that no person is entitled to demand to buy or sell an amount of sterling less than ten thousand at a time. This enables the Bank to meet genuine trade needs and yet guard against hoarding.

III. Monopoly of Bank Notes Issue

The Bank is given a monopoly to issue Bank Notes which are full legal tender in British India. To begin with, however, it was required to take over and issue Currency Notes of the Government of India supplied by the latter, who from the date of such transfer were not to issue any such notes. As soon as the Bank got into working order Rs. 5 crore worth of Rupee Securities were transferred by the Government to the Bank to be allocated to the Reserve Fund.

To guard against confusion or complication, the issue of Bank Notes was to be conducted by a separate Issue Department of the Bank, wholly distinct from its Banking Department. Its assets are free from any liability of the Bank, other than those in regard to Notes only. Weekly publication of Accounts every Thursday of both these Departments is compulsory.

No Notes are issued to the Banking Department or to any other person, except in exchange for other Bank Notes, or for

TABLE V

Various Denominations of Notes in Circulation.

(in lakhs of Rupees)

Year ended (31st March)	Re. 1	Rs. 2	Rs. 2-8	Rs. 5	Rs. 10	Rs. 20	Rs. 50	Rs. 100	Rs. 500**	Rs. 1,000**
1921 ..	9,52	..	51	14,05	52,67	3	3,84	47,22	2,53	17,81
1925 ..	4,15	.4	4	15,83	68,57	2	2,61	63,87	2,32	13,11
1930 ..	35	..	1	20,97	69,08	2	1,60	58,88	84	10,78
1935 ..	32	..	1	25,28	69,31	1	1,34	62,35	53	12,84
1940 ..	32	..	1	44,03	97,83	1	61	80,44	33	17,64
1941 ..	32	..	1	62,23	134,89	1	51	113,13	36	28,20
1942* ..	32	..	1	106,74	218,21	1	46	202,82	52	54,07
1943* ..	32	5,56	1	142,48	302,93	1	37	291,54	60	90,99
1944* ..	32	9,73	1	148,80	363,38	1	30	382,51	32	100,93
1945* ..	32	14,45	1	153,87	425,37	..	25	495,84	26	113,37
1946* ..	32	25,42	1	197,09	545,40	..	19	488,71	3	1,31
1047* ..	32	33,09	1	195,10	557,70	..	16	540,11	3	1,12
		2.5%		14.7%	42.0%			40.7%		.1%

* India notes only.

** Demonetised from 12th January 1946.

Source:—Report on Currency & Finance 1948 issued by the Reserve Bank of India. (page 183).

such coin, bullion or securities as are allowed to be part of the Reserve.

The denominations fixed by law of Notes are:—Five rupees, ten rupees, fifty rupees, one hundred rupees, five hundred rupees, one thousand rupees, and ten thousand rupees. Since January 12th, 1946, thousand and ten thousand rupee notes have been demonetised, and thrown out of circulation; while rupees fifty notes have been long since discontinued. (See Table on page 42.)

Assets of the Issue Department

The Assets of the Issue Department consist of gold coin, gold bullion, sterling securities, rupee coin and rupee securities. The aggregate of all these must equal the total of the Department's liabilities in respect of the total notes issued.

Of the total assets, not less than 40% must consist of gold coin, gold bullion, or sterling securities. Of these gold coin and gold bullion must at any time be not less than forty crores of rupees in value. Though sterling was classed, quite improperly, along with gold, and has consequently resulted in our present problem of Sterling Balances, the fixation by law of a minimum reserve in gold of Rs. 100 crores, corresponded to 40% of the total notes in circulation at the time the Act was passed.

Of the gold held in reserve 17/20ths must be kept in India, and the whole of it wherever held must be in the custody of the Bank. Cash balances held abroad are to be considered as part of the Sterling Securities. The Gold in the Gold Standard, and that in the Paper Currency Reserve, were incidentally amalgamated, and transferred to the Bank.

The balance of the assets must be rupee coin, rupee securities, and such bills of exchange and promissory notes, payable in British India, as are eligible for purchase by the Bank. Rupee securities must not exceed one-fourth of the total assets, or Rs. fifty crores whichever is greater, or, with Government's previous sanction, of such amount plus Rs. ten crores. The Bills of exchange and promissory Notes, thus introduced in the Reserve, provide the only element of elasticity in our paper currency system.

For the purpose of the currency reserve, Gold is valued at 8.47512 grains of fine gold per rupee. This is far below the present market price of that metal. The present value of the Rs. 44.4 crores of gold in our Paper Currency Reserve would be over Rs. 135 crores. Rupees are valued at face value notwithstanding the reduction in silver content of the rupee; and rupee at the market rate for the time being.

The Act makes arrangements for the supply of rupee coins to the Bank against Notes. In future such coins will only be issued by the Bank and not by Government, though the latter retained the right of coinage for themselves.

Bank Rate

In order effectively to control the credit as well as currency system of the country, and to co-relate the two in the interests of the national economy, the Bank is empowered to have the cash balances of all the Scheduled Banks. Each Bank must maintain an interest-free balance of not less than 5% of its demand liabilities, and 2% of the fixed deposits, subject to a minimum of Rs. 1 lakh.

The Bank must make public from time to time the standard rate at which it is prepared to buy or re-discount bills of exchange or other commercial papers eligible for purchase under the Act. This is the foundation of the so-called Open Market operations of the Bank. The Bank Rate functions as the regulating norm round which the Money Market as a whole adjusts itself. Ever since its inception, a policy of cheap money, and, therefore, a low rate of interest has been followed by the Bank, which has, however, brought no real industrial resurgence in the country.

IV. Agricultural Credit Department

This is intended:—

(a) to maintain an expert staff to study all questions of agricultural credit, and

(b) to co-ordinate the Bank operations in connection with agricultural credit, and its relations with provincial co-operative banks or other banks engaged in the business of agricultural credit.

This Department cannot, indeed, render direct assistance to Agriculture, though it is the country's largest single, and the most productive, industry; and so cannot help in its revival, as one might expect. For an effective revival, Indian agriculture needs not only capital, or the tools and instruments, equipment or facilities which capital can provide; but, much more, a radical reorganisation and reconditioning of the entire system of land-holding and cultivation, without which all other improvements would only be so much patch work. This is explained more fully in other volumes in this Series, and so no more need be said on that subject here.

The Reserve Bank's assistance to Agriculture is rendered through the Scheduled Banks, in so far as the latter them-

selves engage in such operations; or, more commonly, through the Provincial Co-operative Banks. Agricultural Bills, endorsed by some intermediary Banks, are limited to those drawn to facilitate or expedite seasonal agricultural operations, or to market crops. The maximum period, again, for which such help can be given, is limited to a relatively short period, sufficient, it is thought, to enable the agriculturist to tide over a temporary or seasonal shortage of funds.

Restrictions on Business

The Reserve Bank is forbidden, subject to exceptions allowed in ss. 17, 18 and 45 of the Act, to:—

(1) engage in trade or otherwise have a direct interest in any commercial, industrial or other undertaking. If any interest is acquired in the course of the satisfaction of any claims of the Bank, it must be disposed of at the earliest opportunity;

(2) purchase its own shares or those of any other company, or grant loans upon the security of any such shares;

(3) advance money on mortgage of immovable property, or become the owner of immovable property, except its own business premises and residences for its officers and servants;

(4) make loans or advances;

(5) draw or accept bills payable otherwise than on demand;

(6) allow interest on deposits or current accounts.

The Act requires the Bank, at the earliest practicable date, and in any case within three years from its start, to report to Government, with proposals, if it thinks fit, for legislation, on the following matters, namely:—

When the Bank is of opinion that the international monetary position has become sufficiently clear and stable to make it possible to determine what will be suitable as a permanent basis for the Indian monetary system, and to frame permanent measures for a monetary standard.

Nationalisation of Reserve Bank

Provision is made for converting the Bank into a Government concern by a special section of the Act. In the event of the Bank being ordered to be liquidated or wound up, the

TABLE VI-A.

Statement of Affairs of the Reserve Bank of India, Banking Department, as on the 10th Sept. 1948

LIABILITIES	Rs.	ASSETS	Rs.
Capital Paid up	5,00,00,000	Notes	30,74,21,000
Reserve Fund	5,00,00,000	Rupee Coin	6,92,000
Deposits:—		Subsidiary Coin	1,59,000
(a) Government			
Central Government	216,43,44,000	Bills Purchased & Discounted:—	
Other Governments	17,31,98,000	(a) Internal	36,23,000
		(b) External	—
(b) Banks	97,39,63,000	(c) Govt. Treasury Bills	3,88,53,000
(c) Others	56,98,44,000		
		Balance held abroad*	308,73,40,000
Bills Payable	3,98,35,000	Loans & Advances to Govts.	10,00,000
		Other Loans and Advances	6,25,000
Other Liabilities	7,80,62,000	Investments	63,34,68,000
		Other Assets	2,60,65,000
	4,09,92,46,000		409,92,46,000

*Includes Cash & Short term Securities.
Dated the 15th Day of September 1948.

TABLE VI-B.

An Account pursuant to the Reserve Bank of India Act 1934, for the week ended the 10th day of September 1948
Issue Department

LIABILITIES	Rs.	Rs.	ASSETS		
Notes held in the Banking Dept.	30,74,21,000		A. Gold Coin & Bullion:		
			(a) Held in India ..	42,71,91,000	
Notes in circulation ..	12,18,01,28,000		(b) Held outside India		
Total Notes issued .. .		12,48,75,49,000	Sterling Securities	796,64,28,000	
			Total A. ..		8,39,36,19,000
			B. Rupee Coin ..		45,07,81,000
			Govt. of India Sterling Securities ..		3,64,31,49,000
			Internal Bills of Exchange & Other Commercial Paper		
Total Liabilities ..		12,48,75,49,000	Total Assets:— ..		12,48,75,49,000

Ratio of Total of A to Liabilities: 67.216 per cent.

C. R. TREVOR,
Deputy Governor.

Reserve Fund and Surplus assets, of the Bank must be divided between Government and the shareholders in the proportion of three to one respectively. But the total amount payable to any shareholder must not exceed the paid up value of the shares held by him by more than one per cent for each year after the commencement of this Act subject to a maximum of 25% It was under this Section that the capital of the Bank held by private individuals was transferred to the State, by special legislation in September, 1948. (See Tables on 46, 47.)

(2) The Imperial Bank of India

The Imperial Bank of India is a wholly private corporation founded in 1920 by the amalgamation of the old Presidency Banks. It was given a good deal of Government business, which, however, was withdrawn from it on the foundation of the Reserve Bank. An agreement was made with the latter whereby the Imperial Bank was continued as a private Bank for another fifteen years at the end of which that institution will also be nationalised, very likely in 1949.

Government Agency Business

The Imperial Bank of India becomes the sole agent of the Reserve Bank at all places in British India where a branch of the Imperial Bank was in existence at the commencement of the Reserve Bank of India Act, 1934, and where there was no branch of the Banking Department of the Reserve Bank.

In consideration of the performance of the Agency duties, the Reserve Bank pays to the Imperial Bank during the first ten years of the agreement a commission of 1/16 per cent. on the first 250 crores, and 1/32 per cent. on the remainder of the total of the receipts and disbursements dealt with annually on account of Government. As for the remaining five years the remuneration to be paid to the Imperial Bank is to be determined on the basis of the actual cost to the Imperial Bank of India, of doing this agency work.

The first ten years of the agreement having come to a close in 1945, the rates of remuneration were revised as from April, 1945. The revised rates also allow commission to the Imperial Bank of the turnover of Government account at 1/16th% on the first 150 crores, 1/32 of one per cent. on the next 150 crores (in place of the remainder), 1/64th of one per cent. on the next 300 crores, and 1/128th of one per cent. on the remainder of the total receipts and disbursements dealt with annually on account of Government.

Reserve Bank Agency Business

In consideration of the maintenance by the Imperial Bank of India of branches not less in number than those existing at the commencement of the Reserve Bank of India Act, the Reserve Bank of India shall, until the expiry of 15 years, make to the Imperial Bank the following payments:—

(1) during the first five years of this agreement Rs. 9 lacs per annum;

(2) during the next five years of the agreement Rs. 6 lacs per annum; and

(3) during the next five years of the agreement Rs. 4 lacs per annum.

Other Business

The Act constituting this Bank has defined the various types of business which the Bank may transact. Any business not expressly permitted is forbidden.

Briefly stated, the main classes of business sanctioned are:—

1. Advancing money upon the security of:—
   (a) Stocks, etc., or Trustee Securities, and shares of the Reserve Bank of India.
   (b) Securities issued by State-aided Railways.
   (c) Debentures, or other securities issued by a district or municipal board, or any State in India.
   (d) Debentures of companies with limited liability registered in India or elsewhere.
   (e) Goods, or documents of title thereto, deposited with, or assigned to the Bank.
   (f) Goods hypothecated to the Bank against advances.
   (g) Accepted Bills of Exchange or Promissory Notes.
   (h) Fully paid shares of Companies with limited liability, or immovable property or documents of title relating thereto, as collateral security where the original security is one of those specified in 'a' to 'f', and, if authorised by the Central Board, in 'g'.

2. Selling of promissory notes, debentures, stock-receipts, bonds, annuities, stock, shares, securities or goods or documents of title to goods deposited with or assigned to the Bank as security for advances.

3. With the sanction of the Provincial Government, advancing money to Courts of Wards upon security of estates in their charge, for the period not exceeding nine months in the case of advances relating to the financing of seasonal agricultural operations or six months in other cases.

4. Drawing, accepting, discounting, buying and selling of bills of exchange, and other negotiable securities.

5. Investing the Bank's funds in the securities referred to in (1) a, b, c, and d.

6. Making, issuing and circulating of bank post-bills and letters of credit to order or otherwise than to the bearer on demand.

7. Buying and selling gold and silver.

8. Receiving deposits.

9. Receiving securities for safe custody.

10. Selling and acquiring such properties as may come into the Bank's possession in satisfaction of claims.

11. Transacting agency business on commission and the entering into of contracts of indemnity, suretyship or guarantee.

12. Acting as Administrator, for winding up estates.

13. Drawing bills of exchange and granting letters of credit payable out of India.

14. Buying of bills of exchange payable out of India at any usance not exceeding nine months in the case of bills relating to the financing of seasonal agricultural operations, or six months in other cases.

15. Borrowing money upon security of assets of the Bank.

16. Subsidizing the pension funds of the Presidency Banks; and

17. Generally, the doing of the various kinds of business including foreign exchange business.

(a) The Bank must not make any loan or advance:—

1. For a longer period than six months, except as provided in clauses 3 and 14 above;
2. upon the security of its own stock or shares;
3. save in the case of estates specified in Part 1 (Courts of Ward) upon mortgage or security of immovable property or documents of title thereof.

(b) The amount which may be advanced to any individual or partnership is limited.

TABLE VII

Statement of Affairs of the Imperial Bank of India as on 10th September, 1948.

LIABILITIES	Rs.	Rs.	ASSETS	Rs.	Rs.
1. **Capital:**			1. Investments:—		
(a) Authorised ..	11,25,00,000		(i) Government Securities ..	153,88,31,000	
(b) Issued & Subscribed ..	11,25,00,000		(ii) Authorised investment ..	10,29,00,000	164,17,31,000
(c) **Called up:**			2. Advances:—		
(i) fully paid ..	3,75,00,000		Loans ..	15,68,54,000	
(ii) paid up (1,50,000 shares of 500 each) ..	1,87,50,000	5,62,50,000	Cash Credit & Overdrafts	52,65,65,000	
2. Reserve Liability of the Shareholders ..		5,62,50,000	Bills discounted & Purchased ..	3,88,96,000	72,23,15,000
3. Reserve Fund ..		6,25,00,000	3. Liability of Constituents for Acceptance per contra ..	Nil	
4. Fixed Deposit, Saving Bank Current & Other Accounts ..		287,98,32,000	4. Dead Stock ..	1,55,08,000	1,55,08,000
5. Loans against Securities per contra ..	Nil	—	5. Sundries ..	1,36,46,000	1,36,46,000
6. Acceptances for Constituents ..	Nil	—	6. Bullion ..	Nil	
7. Sundries ..		96,91,000	7. Cash in hand with the Reserve Bank ..	55,06,07,000	
			Cash with other Banks	6,44,66,000	61,50,73,000
TOTAL ..		300,82,73,000	TOTAL ..		300,82,73,000

* Times of India Dated 17-9-48.

(c) Discounts cannot be made or advances on personal security given unless such discounts or advances carry with them the several responsibilities of at least two persons or firms, unconnected with each other in general partnership.

(d) Discounts cannot be made or advances given against any security not being a security in which a trustee may invest trust money under the Indian Trusts Act, 1882.

3. The Exchange Banks

Besides these two Central Banks, which are either already nationalised in regard to ownership and management, or will soon be, and which are concerned principally with public banking business, the bulk of the country's banking business, is conducted by the so-called Scheduled Banks, including Exchange Banks as well as Indian Joint Stock Banks. The former who were earlier in the field, were pioneers in the modern type of banking business, and were confined largely to financing the foreign trade of India. The latter have grown in imitation of the former, and generally conduct their business on the same lines.

The Banks carrying on Exchange business in India are merely branch agencies of Banks having their head offices in London, on the Continent of Europe, in the Far East like Japan, and the United States. Originally their business was confined as just remarked almost exclusively to the financing of the external trade of India; but in recent years most of them, while continuing to finance this part of India's trade, have taken an active part in the financing of the internal portion also at the places where their branches are situated.

At one time the Banks carried on their operations in India almost entirely with money borrowed elsewhere, principally in London which was considered to be the central money-market of the world. The home offices of these Banks attracted deposits for use in India by offering rates of interest comparatively higher than the English Banks were able to quote. Within recent years, however, they have found it possible to attract deposits in India on quite as favourable terms as can be done in London and so their Indian deposits are actually in excess of those held abroad. A very large proportion of the trade finance by Exchange Banks is now carried through by money actually raised in India.

The following statement taken from the Statistical Tables relating to Banks in India, published by the Reserve Bank of India, shows how considerable is the volume of deposits held by these foreign Banks, how rapidly they have expanded, and the character of the business done by them.

TABLE VIII

Capital, Reserves, Deposits and Cash Balances of the Exchange Banks.

As on		No. of Banks	Capital & Reserves Total	Deposits Out of India	Deposits In India	Cash Balances Out of India	Cash Balances In India*
			£(1,000)	£(1,000)	Rs. (1,000)	£(1,000)	Rs. (1,000)
31st Dec.	1920	15	90,217	513,671	74,80,71	84,197	25,17,53
" "	1930	18	193,616	1,196,060	68,11,44	208,923	7,70,89
" "	1940	20	128,244	1,804,283	85,32,81	608,854	17,19,40
" "	1941	17	105,953	1,642,138	106,73,07	481,849	13,39,75
" "	1942	16	106,686	1,867,148	116,85,27	537,461	12,00,96
" "	1943	16	119,855	2,054,865	140,21,13	556,537	17,24,47
" "	1944 A	5	16.997	115,085	101,91,31	40,323	14,74,04
" "	B	10	117,005	2,359,829	63,29,82	533,621	10,08,05
	Total	15	134,002	2,474.914	165,21,13	573,944	24,82,09
" "	1945 A	6	18,797	128,769	113,41,47	36,108	15,52,20
" "	B	9	134,133	3,607,286	70,32,03	2,311,123	11,29,88
	Total	15	152,930	3,736,055	183,73,50	2,347,231	26,82,08
" "	1946 A	3	6,675	74,124	61,29,70	23,407	7,56,84
" "	B	12	149,447	2,606,034	119,98,76	682.527	24,45,35
	Total	15	156,122	2,680,158	181,28,46	705,934	32,02,19

A.—Banks doing a considerable portion of their business in India, i.e., having 25 per cent. or more of their deposits in India.

B.—Banks which are merely agencies of large banking corporations doing a major portion of their business abroad, i.e. having less than 25 per cent. of their deposits in India.

Note:—1. The wide changes in the summary figures of exchange banks for the years 1945 and 1946 are due to inflation and consequent depreciation of exchange in China affecting the balance sheets of two Chinese banks included in this table.

* Includes figures for Burma up to 1941.

Source: Statistical Tables, 1948, issued by the Reserve Bank.

Exchange Bank's Investments

True to their name as well as origin, these Exchange Banks invest their resources in India, to a great extent, in the purchase of bills drawn against imports and exports to and from India. The financing of our Imports from overseas countries is done mostly by their Branches outside India. The Indian Branches' share in the business consists principally in collecting the amount of the bills at maturity, and in furnishing their other branches with information as to the means and standing of the drawees of the bills. The Indian Branches of these Banks are more immediately concerned with the Export trade, where they have even today, practically a monopoly. In view of the dimensions of that trade, the Banks would under ordinary circumstances require to utilise a very large proportion of their resources in carrying through the business. They are able, however, by a system of a rediscount in London, to limit the employment of their own resources to a comparatively small figure in relation to the business they actually put through. No definite information can be secured as to the extent to which rediscounting in London is carried on; but the figures given on the previous page show a considerable proportion of that business.

The bills against exports are largely drawn at three month's sight, and may either be "clean" or be accompanied by the documents relating to the goods in respect of which they are drawn. Most of them are drawn on well-known firms abroad, or against credits opened by Banks or financial houses in England. Bearing as they do an Exchange Bank endorsement they are steadily taken up by the discount houses and Banks in London. And bills purchased in India are sent home by the first possible Mail so that presuming they are rediscounted as soon as they reach London, the Exchange Banks are able to turn over their investment in about 16 or 17 days instead of three months which would be the case if they were unable to rediscount.

Not all such bills are rediscounted as at times it suits the Banks to hold up the discount rate. They also prefer at times to hold the bills on their own account as an investment until maturity.

The resources in India of these Banks for the purpose of purchasing export bills, are found in a variety of ways, e.g.

1. Proceeds of import bills as they mature.
2. Sale of drafts and telegraphic transfers payable in London and elsewhere out of India.
3. Purchase of telegraphic transfers payable in India by the Reserve Bank.

4. Formerly they used also to import bar gold and silver bullion, as well as sovereigns from London, Egypt or Australia. But in the War these imports are only through the Reserve Bank.

The remaining business transacted by the Banks in India is the usual commercial banking, or short term investments in liquid commercial loans and advances, or discount of local paper through indigenous bankers, shroffs or money lenders.

Joint Stock Banks

Previous to 1906 there were few Indian owned Banks of the modern type operating in this country; and such as were then in existence were of comparatively small importance, with their business confined to a very restricted area. The rapid development of the Indian owned and Indian manned (largely) Joint Stock Bank—which has been so marked a feature in Banking within recent years, really began with the establishment of the Bank of India and the Indian Specie Bank in 1906. In the wave of Swadeshi that swept the country at that time, there was a great boom in new floatations. Many of these new ventures in a somewhat unfamiliar field confined themselves to legitimate banking business. A few, however, were tempted by the prospect of high returns from somewhat risky business, particularly bullion; and so came to grief within a few years after their start. The Banking crisis of 1913 gave a set back which was neutralised by the boom engendered by the War of 1914-1918.

In the interval between the two wars, Indian banking made good progress, as the figures given elsewhere indicate. Confidence has been largely restored, particularly with the prospect of a national Government in independent self-governing India. The failure of the Alliance Bank of Simla and the prompt assistance given by the Imperial Bank, in close association with the Government of India made Indian banking interests perceive the need for a truly national and actively sympathetic Government, if the country's economy was to develop as it should. A banking venture in a wholly new field, viz. to finance long-term investment in, productive industry was tried by the Tatas soon after the end of World War I. But the Tata Industrial Bank, could not continue in face of the apathy or worse of the other banking interests, as well as Government, and so had to be merged with an ordinary Commercial bank of Indian ownership and management.

Statistics given on pp. 56 & 57 show the growth of business and present position of the principal Indian Joint Stock Banks.

TABLE IX

Capital, Reserves, Deposits, Cash Balances and other Particulars Relating to the Principal Indian Joint Stock Banks.

Class A1—Banks having Paid-up Capital and Reserves of Rs. 5 lacs and over—Scheduled Banks (excluding Imperial Bank of India).

(In Thousands of Rupees)

As on	No. of reporting banks	Capital & Reserve Total	Deposits	Cash in Hand and at Banks
1920	25	10,92,48	71,14,64	16,30,70
1930	31	11,90,15	63,25,51	7,67,91
1935**	38	13,19,85	84,44,61	19,12,15
1940	41	12,67,08	106,10,08	25,02,43
1941	44	13,59,90	129,04,39	24,20,66
1942	44	16,25,37	189,33,83	43,76,69
1943	57	23,72,15	324,50,08	74,24,85
1944	69	32,05,78	436,56,86	90,40,15
1945	75	38,77,10	542,80,07	106,22,80
1946	80	44,16,62	624,23,37	120,75,57

** Figures upto 1935 include all Banks with Capital and Reserve of Rs. 5 lakhs and over. Figures since 1936 are for Indian Scheduled Banks only.

Source: Statistical Tables, 1948, issued by the Reserve Bank.

5. Indian Private Bankers and Shroffs

Indian private Bankers and Shroffs have been doing banking business from time immemorial, long before Joint Stock Banks were ever thought of; and they are likely to continue to thrive for some very considerable time to come. So long as the principle of private enterprise in such Public Utility Services is maintained, there is no danger for them. And even when the entire Banking business is nationalised, they will continue to do this work as public servants; and not as private profit-seekers. Their knowledge and experience are too valuable to be lost to the public Service. Only their outlook will have to be readjusted; their motive spring recast; their methods and technique reconditioned. A properly planned national economy must provide work for all citizens who are capable of working, work suited to their training, aptitude and experience; and this part of the nation's business is too crucial to be left to novices.

TABLE X

Demand and Time Liabilities, Cash Balances, Advances and Bills Discounted of Scheduled Banks including Exchange Banks as shown by their weekly returns as on the last Friday of each year.

(In Lakhs of Rupees).

Year.	No. of Reporting Banks.	Demand Liabilities.	Time Liabilities.	Total Demand & Time Liabilities.	Cash in hand & balances with R.B.I.	Percentage of Cash balances to demand & time liabilities.	Advances.	Bills discounted.	Percentage of Advances & Bills discounted to total demand and time liabilities.	Total number of offices including branches, pay offices, etc. in India.
1935	49	121,93	98,67	220,60	35,88	16.26	83,31	3,52	39.36	723
1940	62	174,94	100,76	275,70	57,08	20.70	1,01,45	2,40	37.67	1,351
1941	62	224,73	112,79	337,52	41,70	12.35	1,22,57	6,35	38.19	1,454
1942	61*	335,06	114,04	446,10	63.89	14.32	95,37	2,97	22.04	1,450
1943	74*	500,82	157,28	658,10	116,21	17.66	1,60,86	6,74	25.47	1,882
1944	84*	616,09	202,92	819,01	106,07	12.95	235,80	13,41	30.43	2,443
1945	91*	672,57	280,26	952.83	120,83	12.68	302,89	24,30	34.34	2,947
1946	96*	730,16	330,95	1,061,11	117,28	11.05	442,31	22,88	43.84	3,519

Number of Offices including branches, pay offices, etc. in India (1946).

I. **Scheduled Banks.**	
i. Imperial Bank of India	443
ii. Exchange Banks	77
iii. Other Scheduled Banks	2,949
2. **Non-Scheduled Banks.**	
i. Banks having paid-up capital and reserves of Rs. 1 lakh and over	2,194
ii. Banks having paid-up Capital and Reserves of Rs. 50,000 and Rs. 1 lakh ..	494
iii. Banks with Paid-up capital and reserves below Rs. 50,000	553
3. **Co-operative Banks.**	
i. Banks having paid-up capital and reserves of Rs. 5 lakhs and over ..	207
ii. Banks having paid up capital between Rs. 1 lakh and Rs. 5 lakhs ..	372

* Burma Scheduled Banks excluded.

Source: Statistical Tables relating to Banks in India 1946

The term "Shroff" derived from the Arabic sharif—a good person of good standing—is used, in this connection, nowadays for a person who charges usurious rates of interest to impecunious people or a mere usurious moneylender. This is, however, hardly fair to the people known as "shroffs" in banking language as the latter are of very real service to the business community. They serve as feeders to the Joint Stock or Exchange Banks in India, as they are in direct touch with the producer. Under present condition the Banks in India can never hope to be able to get into sufficiently close touch with the real primary producer, the country shopkeeper, who handles the bulk of the internal trade in India to enable them to grant accommodation to more than a fraction of these traders direct; and it is in his capacity as middleman that the "Shroff" proves of such great service. In the same way he brings a very considerable volume of business within the scope of the Imperial Bank and enables the latter to give accommodation, which, without his assistance, that Bank and the Scheduled Banks would not be permitted to give. The modus operandi for a shroff as an intermediary between the trading community and the Banks arises as follows. A shopkeeper in the bazaar,with limited means of his own, finds that, after using all his own money, he still requires say Rs. 25,000 to stock his shop adequately. He thereupon approaches the "shroff", and the latter, after very careful inquiries as to the shopkeeper's standing, grants the accommodation, if he is satisfied that the business is safe. The business, as a rule, is arranged through a **hoondee** broker, and in the case referred to the latter may probably approach about ten shroffs and secure accommodation from them to the extent of Rs. 2,500 each. A **hoondee** which is our version of a Bill of Exchange, usually drawn at a currency of about 2 months, is almost invariably taken by the shroffs in respect of such advances.

In this the Shroff primarily invests his own capital, if the business coming to him in this way is much larger than his own resources can cope with, he seeks assistance from his Bank. A number of the bills held by him are taken to the Bank for discount, under his own endorsement; and the Bank accepts such bills freely as they are doubly secured. The extent to which the Bills of a Shroff would be discounted by the Bank is determined by the standing of the shroff and the strength of the drawers. The extent to which any one Shroff may grant accommodation in the bazaar is, therefore, dependent on two factors, viz:—

1. the limit which he himself may think it advisable to place on his transactions; and

2. the extent to which the Banks are prepared to discount bills bearing his endorsement.

The Shroffs keep in very close touch with all the traders to whom they grant accommodation, and past experience has shown that the class of business above referred to is one of the safest the Banks can engage in.

The rates charged by a Shroff are usually based on the rates at which he in turn can discount the bills with the Banks. They necessarily vary according to the standing of the borrower and with the season of the year. Generally speaking, however, a charge of two annas per cent, per mensem above the Bank's rate of discount, or 1½% is a fair average rate charged in Bombay to a first class borrower. Rates in Calcutta and Madras are on a slightly higher scale than in Bombay due in a great measure to the fact that the competition among the Marwari and Multani Shroffs for business is not so keen in these places as it is in Bombay.

The resources of these indigenous bankers are mainly their own capital; but they also receive deposits whose volume, however, is not known. So far they have not been subject to any legislative regulation of their business. So long, however, as they confine themselves to their traditional work, and keep away from speculation on the stock, bullion, cotton, or commodities exchanges, they are safe, and earn a fair living. But once the virus of easy money, or unearned income enters their veins, and that seems almost unavoidable in these great haunts of modern business in India—the safety of their business, their credit and security inevitably suffer. If, and when, therefore, banking comes to be regulated and controlled, as a great public utility service, and as integral part of a planned national economy, these individualist, indigenous bankers cannot be suffered to remain untouched, and frustrate by their individualist operations the success of the Plan.

6. Co-operative Credit Societies

The Co-operative Credit Societies, which do banking business mainly in connection with Agriculturists; and the Land Mortgage Banks, which seek to assist land-holders or tenant-cultivators to develop their holdings, have been considered in other volumes in this Series dealing with Crop Planning, Land Policy, Rural Marketing. It is unnecessary, therefore, to cover the same ground over again. We must point out, however, that these institutions keep severely to the initial purpose of dealing with relatively small producers. They are unable to assist them into transforming Agriculture, or Land

cultivation into modern, large-scale, mechanised Industry; and so fail to aid actively in the most important sector of our National Economy. Their methods of business are mechanical; their outlook necessarily restricted; their field of operations rigidly limited. They will have to be much more expansive and liberalised, and knitted together more closely with the rest of the Banking organisation of the country, if they are to do any real service in the cause of planned economic development of the country.

7. Land Mortgage Banks

Essentially the same criticism applies to the Land Mortgage Banks. It must be added, however, that the restricted nature of their work is not of their own doing. The laws relating to land tenure, and the social system in general affecting immovable property, make active development by these institutions, as in a largescale industry, all but impossible.

8. Industrial Finance

In the Volume dealing with Industrial Finance, some space has been devoted to the recently established Industrial Finance Corporation, and the place of such Institutions in the progressive development of the National Economy; and so no more need be said on that head in this place. Similarly, also, the work and shortcomings of the Post Office Savings Banks have been reviewed in that volume. It is needless, therefore, to repeat ourselves.

VIII. Review of Banking Business in India

Having reviewed the principal types of Banks and Banking business in this country, we may now sum up their chief characteristics or shortcomings.

1. Practically all the banking business in this country today is of the orthodox commercial type, familiar chiefly in Britain. Our Banks have no concern, directly, with the all-round economic development of the country, its productive capacity or distributive justice.

There are, no doubt, special types of Banks, like the Cooperative Credit Societies, and Land Mortgage Banks, which are concerned with financing Agriculture. The Industrial Finance Corporation, recently established, is expected similarly to minister to large and small industry. But all these are restricted in their operations, both as regards the actual field open to them, and the nature of business they are permitted or accustomed to do.

So long as the country's industrial or agricultural productive capacity remains thus unaided by new capital, or fresh impulse provided by new investment, the progressive development of our productive resources, and ensuring of better distribution, would be impossible.

In a planned economy, therefore, it is of the utmost importance that Banking should be varied, and should meet all the requirements of every sector of the country's economy, in production as well as distribution, for Government as well as for the people at large. It is not necessary, nor even wise, that each bank should do all kinds of banking business. But there must be appropriate institutions for the different types of banking business; and they should all be co-ordinated at the apex.

Without minimising the importance of trade, both domestic and foreign, and the need to finance it adequately and appropriately, it may yet be pointed out that so long as our National Economy remains on the basis of **Production for Exchange** and not **Production for Use**, Finance Capital would have a disproportionate importance; and Banking of the type reviewed above will almost entirely monopolise this essential Public Utility and Social Service. Banking concerned with trade finance is, no doubt, a service; but it is not productive in the sense that financing Industry or Agriculture would be.

2. That Banking is a Public Utility and a Social Service, which, though not directly productive, can be an essential aid in producing new wealth, and so improving the general standard of living, seems scarcely realised in this country. The place of Banking, therefore, in the scheme of active development of the National Economy of a country like this is scarcely appreciated. Those, therefore, who have the carrying out of a planned programme of development in their hands will have not only to see to it that Banking as a whole, in all its varied forms and functions, is adopted as a truly national concern operating mainly for developing the country's productive capacity and ensuring better distribution, most effectively as a socialised organisation; but they must also adapt the several types to the different kinds of business or service required from Banks.

Even if the wholesale Nationalisation of all Banks and the entire field of banking business is, for any reason, deferred, the socialised Reserve Bank of India and the soon-to-be socialised Imperial Bank, working from the top must so conduct their operations, and so control and regulate the other Banks working along with them in the several fields of the

country's commerce, industry, and agriculture, mining and forestry, as to keep all the various sectors in line, and make all of them contribute to the same end.

3. Because of this leading feature of banking in India operating mainly as commercial financing institutions, the facilities and service Banks have evolved or are accustomed to perform, are necessarily of a corresponding character.

The supplementing that Banks are expected and accustomed to render in other countries to the currency system of the country by Deposit Currency, or Cheque Money, is confined to a very small section of the community, as the Clearing House Statistics, given in the review, show. There is no direct link, functioning automatically, between the Currency and Credit systems of the country. The volume of Currency in circulation is practically impossible to expand or contract in accordance with the varying needs of business simply because of this lacuna. A properly planned national economy must forge such a link at the earliest opportunity, particularly if the price mechanism is to function as an integral part of the National Plan.

4. Thanks to their origin and development as commerce financing bodies, Banks have not developed Forms or Instruments of Credit, which could help to minimise the use of metallic money, and the reserve needed against Paper Currency. There is no means to mop up and utilise the surplus of production over consumption as soon as it is formed. Such devices as the **Postal Cheque** or the **Giro System**, which before the War were quite common on the Continent of Europe, are unknown. Even Traveller's Cheques and Letters of Credit operate in a very limited field, and mostly by Non-Indian Banking interests.

Land Mortgage Debentures or Industrial Bonds, payable to bearer, or transferable with the least difficulty, which could bring fresh blood from time to time in the body economic, are equally untried.

As explained in the Volume in this Series dealing with Industrial Finance, the history of the various types of Savings, including those in the Post Office Savings Bank, shows large room for further expansion, which is yet undeveloped by Banks or Government. The mobilisation, therefore, of the surplus of production over consumption in the country, such as it may be, and its prompt utilisation for further development of the country's productive capacity are utterly unplanned. If they exist at all, they do so merely as an accident,

not as a matter of set purpose or an item in the planned programme.

5. There are not sufficient Banks to meet the needs of such a large country and its vast population. Statistics given earlier in this section, show the total number of all kinds of banks and their branches to average, for every 50,000 of population. This is comparatively very poor, and will need to be much more expanded, so as to have a bank, or a branch office,—working along with the Post Office, for example, to economise in staff, buildings, etc., for every 1,000 of population.

The question whether the future development of banking in India should take place on the British, or on the American, model, will have to be immediately tackled by the Planning Authority when it comes into being.

The former concentrates banking power, wealth, and influence in a few large banks, each with a net-work of branches spread all over the country, and numbering hundreds. The entire country is covered, every section of the community served by this arrangement. The whole enterprise is however, directed and controlled from one centre. The smaller or country-banker, who knows the local clientele and understands local needs, tends to disappear in this arrangement. Local needs likewise, of particular industries, agriculture, or trade, also tend to be subordinated to the requirements of the few central places, or even one business centre, like the city of London.

In the latter or decentralised system of banking, as it prevailed in America, each state, city, or township, not to mention still smaller units tends to have its own bank, manned and operated by those familiar with the local economy. The tendency to centralisation has, no doubt, manifested itself in the United States, also. Since World War I the United States banker has begun to pay attention to Foreign Trade Finance, or international banking. But the basic tendency still remains there towards decentralised banking.

In India banking, seems to have hitherto developed on the British model, with a few powerful banks, with large resources, having their head-offices in capital cities, and a growing net-work of branches in all likely centres of commerce, who take up the bulk of the country's banking business. There is in this tendency a danger of lop-sided development, which the Bill now before the Indian Legislature apparently seeks to check. As the Bill stands, however, this check would operate more on new banks coming into being hereafter, than

on those existing in 1948. If the potentialities of this country are taken into account, the past ought to be no guide or model in such matters. Banking must be reorganised almost from the roots upwards. Its form and structure, technique and function must be entirely recast, so as to fit in smoothly with the over-all Plan as and when it comes into being.

6. Banking in India is still to a very considerable extent dominated by Non-Indians. They have evolved the pattern and set the model. The Constitution of the Central Government until August 15, 1947, and such Legislation as relates to Banking in general, have combined to keep these alien vested interests intact. The result is that India's productive capacity meets with an invisible handicap, which needlessly restricts its potential strength.

Legislation now impending for consolidating the law relating to Banks and Banking in India, maintains the same attitude. Any planned programme of national development, however, must reckon with this feature of India's present Banking Organisation, recognise its obstructive or restrictive reaction upon our productive needs, and deal with it so as to make this great Social Service operate in the true interests of the country only, add to its productive organisation, and help secure better and more equitable distribution.

If these suggestions are adopted, Banking will not cease to be as varied in character as it is today. Probably the variety in types of institutions as well as kinds of business done by them, would be much greater, in a properly planned national economy expanding and co-ordinating all activities. But there will have to be a close co-ordination, not only as between the various types of Banks and their business, but also as between Banking and all other Utilities, Services and activities in Industry, Commerce, and Agriculture, so that the capital requirements of every sector may be furnished as easily and effectively,—without excess or deficiency,—as may be necessary.

There is no co-ordinating link in the various types of Banks, functioning in the land, and the several kinds of business they do. The Reserve Bank, now nationalised, is a Central Bank for this country, in charge of its monetary organisation and credit control. Its commercial adjunct, the Imperial Bank of India, is another apex of the pyramid. On the other Banks, there is neither co-ordination nor control, neither regulation nor supervision from some central focal point, to make them all march in step to the prescribed, predetermined goal. This must be provided if Banking is to be

a real service, a great public utility, and an integral part of the National Plan.

IX. Credit System of the Country

While reviewing the Currency and Banking Systems, note has already been taken of the working of the Credit System. Credit is, essentially, anticipation of future wealth, for producing which finance is needed by the producer to meet the expenses of production. It is not wealth actually in existence, it is wealth to be produced as represented by the accommodation sought.

Credit is thus based on the judgment of those who dispense available resources from past savings regarding the capacity of the entrepreneur. It may be done for the individual as for the nation as a whole from indigenous resources or those borrowed from abroad. This is done usually by banks operating at the point where the producer disposes of his production to the consumer through the instrumentality of merchants or other middlemen. It could also be done more directly at the point where the process of production begins, by financing operations, whether in Industry, Agriculture, Commerce, or any form of new production, service, or utility. In the existing social order all over the world outside Russia, a whole host of middlemen are interposed between the primary producer and the elements that own or can dispose of investable surplus of past savings; and they have to be fed. That adds to the cost of production, involves waste or mal-utilisation of the available resources, and neglect of potentialities of new wealth which are either not understood or not favoured by these owners or disponents of the investable surplus. For a country intent upon wholesale planning this needs to be radically remoulded.

From this point of view, in several respects the Currency and Banking System of this country, on which depend the development and functioning of the Credit machinery, is defective. Under planned economy, however, the role of Credit in facilitating the production of new wealth by anticipation would become more important. The anticipation of new wealth would be facilitated automatically, specially if that machinery as well as the means of distribution are socialised. So long, however, as all the Public Utilities, Social Services, and productive activities are not socialised, and private enterprise with its motive spring of private profit remains, there will always be the risk of the institutions dispensing credit and the instruments embodying it being abused or misdirected.

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There may consequently be, at times, an excess of wealth anticipated, or a needless deficiency of such anticipation. Economic crises, or the evils of inflation and unnecessary stringency happen without any co-relation between the potential productive resources of the country, and the means to develop them and produce new wealth. It is of the utmost importance, therefore, that all the instruments as well as institutions concerned with Credit, its forms and applications, should be carefully recast and co-related so as to be assigned their proper place and function in the over-all National Plan.

X. Regulation and Control of Foreign Exchange

In the economic structure before 1914, all Foreign Exchanges were automatically regulated by the functioning of the orthodox Gold Standard, which was the prevailing basis of Currency in the leading commercial countries of the world. It was assumed as an axiom that all ratios in Exchange of the several currencies entering into international trade would be adjusted and all balances settled by the movement of gold to or from given countries which showed, in the aggregate of all the items entering into the balance, an excess of dues from them over the amounts receivable from them exported gold to settle the adverse balance; and **'vice versa'**. The most considerable items in this balance are the imports and exports of merchandise; the former constituting the debits against the country importing, and the latter the credits of the country exporting. But these are not all. There may be a number of "invisible" imports or exports which may swell the balance for or against the country concerned. Trade between nations not being always the exchange of natural surplus or speciality in commodities, and international accounts being complicated by a number of humanly controllable factors, the management of the Foreign Exchanges of a country became a great temptation to the Banking Authorities or the Government of a country. It was also believed that a high ratio depressed the country's own industry, while a low ratio encouraged it, which was an additional temptation. The regulation and control of Foreign Exchanges thus came to demand the exercise of supreme authority of a country even in normal times; while during the War such control became inevitable.

World War I had distributed the assumption of an automatic regulation of Foreign Exchange. The leading currencies of the world had materially depreciated. Though efforts were made after that struggle to return to the orthodox arrangement and working Gold Standard by the principal commercial countries of the world, they had to be soon abandoned because

of the unreality of the assumptions on which they were based and could succeed. Managed currency and controlled and regulated Exchange had become the order of the day for almost every country, even before the World Depression of the early thirties during which even the richest nation of the world,—the United States,—had to abandon its old Gold Standard, artificially depreciate its exchange ratio, and introduce an element of managed exchange, which, however, is still the nearest to the pre-war foreign exchange adjustment.

Britain tried in 1925 to regain her old Gold Standard and fixed exchange; but within six years of its restoration, the so-called bullion standard had to be abandoned by her. The dollar sterling ratio was fluctuating all through the thirties. With the help of America, moreover, Britain has been able all through the war years to maintain a fixed ratio of dollar-sterling exchange, pegged at a little over $4 = £1. But the realities of her economic position make it impossible for her to maintain the pound even at its present highly depreciated rate of exchange with the dollar. Other currencies have almost all depreciated very seriously and so the maintenance of artificial exchange ratios becomes a normal function of the banking authorities in any country.

In India the Ratio in Exchange has been artificial, ever since the Mints were closed to the free coinage of the silver rupee in 1893. The artificial ratio has been fixed primarily in relation to sterling, which at the time was assumed to be as good as gold; but which since has very substantially depreciated after the dislinking of the pound sterling from gold. The perversion or distortion of the provisions regarding the purchase or sale of gold—or now sterling—by Government or the Reserve Bank has given rise to the most complicated post-war problem in Indian Finance, namely, the liquidation of the so-called Sterling Balances. For the last 50 odd years, the Rupee has been a managed currency; and the maintenance of its ratio in exchange not the least of the headaches of the Government or the authorities concerned.

In the section of this volume dealing with the Summary of Developments after the Interim Report of this Sub-Committee was presented, an attempt is made briefly to outline the latest form of Exchange Control as it has been operating in recent years. Old factors have changed and several new ones have entered to complicate the situation. India's sterling debt, for which payments had to be made by exports of goods from here, has disappeared or been repatriated. Other items in the old "Home Charges" have also been eliminated since

the attainment of independence. These have reduced the need for a steady and substantial excess of exports over imports of merchandise which used to be the outstanding feature of our Foreign Trade for all these centuries. On the other hand, India has become a deficit country in the matter of our food supply, and so needs to import grain on a very large scale at very high prices. Her ambition towards progressive industrialisation and planned economy has emphasised the need for importing capital goods, the payment for which is increasingly difficult to make because of the objective to use up all raw materials within the country itself, and even to import some special qualities. During the War, this new development did not manifest itself, as the heavy stream of war supplies to the allies more than wiped off the converse stream. But with the end of the War, the new features have become more and more prominent; and the regulation of our Foreign Exchanges more and more complicated.

It is enough to add here that whatever the origin of this machinery of control and regulation of Foreign Exchanges, it is necessary, and can be made advantageous if it is worked as an integral part of a complete economy. The regulation, needless to add, will have to be with reference not to sterling, but rather to the most stable international medium of exchange, viz: the dollar, which means eventually gold. The statutory link of the rupee with sterling has been already scrapped. And though the Rupee is not yet wholly an independent standard of money, the new orientation in India's foreign trade, must make her think more and more of her exchange ratio with other currencies as well. The controversy about **Stability of Exchanges** vs. **Stability of Prices** is at bottom the same problem; and we in this country have to secure both, while our planned economy is in process of being formed. Ad hoc unco-ordinated control of exchanges is as injurious as such control in any other departments. It is the essence of Planning that there must be strict control in all facets and sectors of the Plan; and it is the essence of such control that it must be both thorough and universal. Exchange control is perhaps the most crucial form, and must, therefore, be considered as an unavoidable part of National Planning so long, at any rate, as foreign trade remains an important adjunct of the working of the national economy, and creates a likely loophole for upsetting or frustrating the Plan through extraneous factors.

Regulation of Metallic and Other Reserves and Mobilisation of Capital Resources

Apart from those already made while discussing the country, no remarks are necessary on these items in the Terms of Reference to this Sub-Committee. If more elucidation is desired, the reader is referred to the Volume on **"Industrial Finance"** in this Series, which deals with the subject of Capital Mobilisation more exhaustively, as also the Promotion of Saving and Investment habits. The Measures necessary for Linking up Rural Credit with the Capital Market are likewise indicated in that and other Volumes dealing with Crop Planning and Rural Marketing and Finance.

K. T. SHAH.

REPORT OF THE CURRENCY AND BANKING

SECTION I

1. The conclusions given here are the briefest summary of highly technical points, and nearly each one of them would have to be elaborated with details, many of which have a bearing, one on the other. Finance cannot be considered by itself in one aspect, and we must record that we had no opportunity of knowing what has happened with regard to Public Finance, Rural Finance, Industrial Finance and other Sub-Committees, whose conclusions might lead to modification in our conclusions or vice versa.

2. It will be further noted that there are no quantitative estimates of requirements of credit or of money. We have gone on the basis that such requirements will be large, but, just as we would be influenced by a statement of these requirements, we in our turn would have asked the National Planning Committee to hold their hand to cut down those requirements to finances available.* This essential interaction is absent in our conclusions, which therefore only affect the structure of banking and currency. But mere structure is secondary, the actual working of the Banking and Currency system must depend on the strain put upon them and if progress was required free from financial crises or breakdown quantities are even more relevant to our work than mere outline of structure. We have made this preliminary report solely in response to the urgent plea of the Chairman's circular letter, but we must utter an emphatic warning that it would be unwise for the National Planning Committee to proceed, without further and fuller report, to the construction of a plan that would break down on the financial side before it had made any appreciable progress.

3. The task before the sub-committee is in the main two-fold. Taking the Banking section first, it is to see how Banking service in India could be extended in volume, and improved in quality, and made cheaper so as to be within the reach of many more than those who are at present served by banks, and also how the Indian money market could be strengthened in structure and otherwise. Credit which can play a very important role has been crippled in India through the breakdown of the indigenous system as it existed during

*Prof Shah pointed out that this matter for estimating the requirements was in the Province of another Sub-Committee.

the last 200 years, and in its place, new institutions or individuals who would serve the community have not been replaced. Some of the measures suggested by us are calculated to secure marked improvement during the next decade in this direction.

4. The position of the Reserve Bank of India as the Central Banking Authority with wide powers—with powers which would be still wider when further regulations are introduced—naturally needs to be altered from the present very unsatisfactory manner in which that institution is functioning, being an unwitting instrument for policies which are injurious to India. The Reserve Bank is not only wholly dominated by Government, but is carrying out policies shaped by the Bank of England and dictated from London. The Indian Directors must be presumed to have failed to show initiative or power for withstanding such policies in India's interests. We therefore suggest immediate nationalisation of that Institution.

5. Banking business of every description must be carried on under a licence, and must be subject to such regulation, supervision and general control as the Central Banking Authority imposes from time to time.

6. As one of the essential conditions of the licence to do banking business in this country, it will be insisted that at least 95% of the personnel will be Indian. In the case of banks registered in this country we see no reason why all directors should not be Indians, the employment of any foreigner in any bank being left open as expert adviser only, and not as chief executive or manager.

7. The phenomenon of banks not registered in India receiving deposits at very low rates, and making this money available to foreign commerce and industry, in competition with Indian enterprise, needs careful examination. One method of dealing with the situation would be to impose a charge of one per cent. on all fixed deposits in banks earning a low rate of interest. We however prefer the other method, as suggested in the Minority Report of the Indian Central Banking Committee, namely to prohibit banks not registered in India from receiving any deposit or raising loans, in the same manner as in the United States of America.

8. Banking service through branches of Joint Sotck or other banks exists in India only to the extent of one banking office for about two and a half lakhs of population, as against one such office for five thousand persons in the United Kingdom. We do not think that this state of affairs can serve the needs of Indian trade and industry satisfactorily, especially

under Planned Economy. We think there is scope for increase of branches of large Joint Stock Banks as well as for smaller banks each of which may confine itself to a locality, where it can have better knowledge of local needs and conditions. But the multiplicity of very small institutions, such as those in Bengal and Travancore, unregulated and unassisted, should be avoided. The indigenous banker, who is increasingly withdrawing capital from banking business, must be reinstated, but in a modern setting, with a certain amount of regulation, in consideration of which he will receive a measure of assistance and recognition. Land and its produce, gold and silver ornaments and other securities, hitherto accepted against advances could be fully restored to their original position in this respect as basis of credit through an all embracing scheme, details of which lack of time prevents us from giving at the present stage.

9. The cheque as an instrument of credit has to some extent undermined the position of hundies; but the hundi system must be revived and reinforced in order to provide an appropriate instrument for short term credit and a suitable investment for commercial banks. Institutions specialised in dealing with hundies and known as Discount Houses, must be brought into existence at once at the principal centres in India, with such special facilities as are considered necessary to enable them to operate on a scale large enough to cover all charges.

10. The work of the Post Office Savings Banks should be enlarged so as to provide the poor man with the same banking facility whether of drawing cheques and transferring funds from one branch to the other, or by any other device like the Giro system.

11. The Postal Savings Bank and Co-operative Credit Societies must provide similar facilities wherever possible on the same terms to their depositors so as to cover all citizens as to remittance.

12. All remittance charges, (not telegraphic), within India should be eliminated by the Reserve Bank permitting Member Banks to draw at one centre and pay at any other centre where the Reserve Bank has a branch or an agent. The Member Banks should allow the same facilities to their clients, subject to a minimum unavoidable charge, the schedule of such charges being approved by the Reserve Bank; and where they have no branch of their own they must make arrangements with agents to provide the same facilities to their clients.

13. The Stock Exchanges should be reorganised, and should work under very strict public control, with a non-official Chairman appointed by Government. Their rules should be scrutinised with reference to the periodical crisis including the technical causes that arise; and revised so as to prevent or minimise such crises.

14. The rules of business of the Stock Exchange must, likewise be revised so as to prevent, or at least keep under rigid control, excessive speculation and cornering, which frighten away or damage genuine investors. Every effort should be made to provide all necessary information through the Stock Exchange so as to help intending investors in their search for safe and productive investment. The Stock Exchange should function so as to promote such investment.

15. We think there is a market in India for bonds, which has not been developed adequately, but it would be wrong to put on this market an undue strain by an excessive supply of Government bonds for all and sundry purposes. We deprecate the system of Government guarantees to private enterprise, which would fritter away public credit without public control. We cannot but utter a word of caution against the scheme of wholesale purchases of zamindaris by issue of bonds or the creation of bonds **ad lib.** for land mortgage banks.* Bonds which are issued must be as a rule of a self liquidating character from the produce or income of the assets against which they are issued and not from the resale of assets as such. We think it absolutely essential that the supply of such bonds from all sources on the market should as a rule be slightly less, instead of slightly more, than the demand. Excessive public debt transferring the burden to the future, must be avoided and the rate of public borrowing could be kept down, if the restraint referred to above were kept in mind. All this has a direct bearing on the amount of deposits, which the banks could receive, as both the money for short-period and long-period bonds, as well as for short-period and long period deposits, come out of the loanable capital available at the moment.

16. All commodity markets, in which future or forward dealings take place, must be under regulations, approved by the State. The State must have the authority, as and when it considers it necessary to put an official on the Board, or an official Chairman of every such commodity exchange. The

*In the opinion of Prof. Shah, bonds issued on the security of Zamindari rights taken over by the State can under certain safeguards be made self-liquidating.

Rules regarding prevention or minimising of speculation mentioned above in paragraph 14 should also apply here, **mutatis mutandi.**

17. The present anarchical condition in the foreign trade of India should be ended. That trade, both as to imports and exports, must be so conducted as to eliminate the competition of Indians with Indians. Increasing use must be made of recognised corporations, especially charged with functions of exporting Indian produce abroad to different countries. In the matter of imports the same rigidity need not be followed, but every effort should be made to secure collective purchases abroad so as to eliminate waste in order to be certain as to quality through inspection, to prevent some isolated Indian buyers being victimised as to prices.

18. All import and export trade must be done under a system of licenses, which should be freely given; but which are so designed as to enable the State to have the fullest information regarding the direction of the trade and to facilitate control and regulation as they are found necessary.

19. This control would be exercised with several objects in view such as guaranteeing the reputation of Indian exports for quality in foreign markets; regulating the direction of the trade, so as to maintain the requisite flow of trade stream in the direction required by a trade treaty if any, and evenly throughout the year as far as possible, keep up the total value of a particular trade, eliminate needless competition between Indians, as and when necessary, in the foreign market, pooling of resources, or costs for dealings abroad, so far as the export trade is concerned. For the import trade, restrictions would be with a view to prevent the entry of commodities, which are deleterious to the health and morals of the people, or which are dumped on this country, or which compete unfairly, or to an excessive degree with articles of local production.

20. The entire Foreign Exchange business of the country should be, conducted through the Reserve Bank.* The Reserve Bank should make Foreign Exchange available to the other banks within limits of safety for the external value of the Indian currency.

21. We think that there is still an unnecessary and heavy drain of funds from the Indian money market in respect of premium payments made to foreign companies doing both life and other forms of insurance in India. Some of the evils from the growth of mushroom companies in connection with Indian

*Prof. Shah is of the opinion that it should be monopolised by the Reserve Bank.

insurance enterprise have been brought under check by the new law, and we think that it is capable of further expansion so as to cover the bulk of such Indian business as there is at present and what might grow in future, as the insurance habit increases. This means of enriching the Indian money market by the retention of these funds in India is one, which we must definitely advocate. Having regard to the needs of the state in an all-embracing plan, we would suggest for serious consideration the extension of the state insurance scheme at present in use by state employees only to the public with a view to eliminate private enterprise in this field (subject to suitable compensation to existing Indian companies). This will, in our opinion, not only permit of the retention of some funds at present leaving the country in India, but of its direct use by the State for purposes, which are essential and which call for larger immediate financial resources, with an absolute ultimate guarantee of payment when the claims arise.

Section II

22. In regard to the Currency portion of our Reference the object should be to see that the Indian currency rests on a basis beneficial to India and is in a form convenient and acceptable to the people. The standard of currency for internal purposes must be stable and safe. The Indian money should have abroad a reputation for soundness and strength; and should be proof against all attacks of speculators or foreign enemies and others.

23. The value of the Indian Currency Unit, whether at home or abroad, should be regulated exclusively by considerations of benefit to the Indian national economy, and not in the ruinous manner as at present, when the Rupee is linked to the Sterling. The linking of the Rupee with the Pound Sterling should not be continued longer than is absolutely necessary, and the link should be broken as early as possible on the reporting of the central banking authority of the country, that they have adequate resources to deal with the situation, which will arise thereafter. The Exchange Control, recommended in sections 18, 19 and 20 is calculated to enable the Central Banking Authority to do this without any difficulty after a year or two at most.

24. The periodical depressions arising from changes in the purchasing power of money should be minimised by the maintenance of several Index Numbers in the States based on different commodities and different considerations but indicating to the Central Monetary Authority in the country, viz. the Reserve Bank, the directions in which fluctuations in the purchasing power are taking place. This authority should try by different methods at its command through the various regulations including the regulation of the volume of currency cutstanding to prevent sudden or prolonged fluctuations affecting the primary producer.

25. No reserves against the Indian Paper Currency, or the Indian Credit and Banking System, should be in Sterling, as hitherto. All such Reserves should be normally in India but the Reserve Bank should have discretion and powers of holding a portion at such places abroad (in gold only in quantities laid down by law) as is considered desirable and necessary, Reserve in gold should not be permitted normally to be kept out of India.

26. No other immediate changes in the currency system of the country are recommended. Every attempt should be made to see that the value of the different denominations of coins or notes, inter se, inside the country is maintained without discount. Sufficient currency of different forms and denominations should be issued according to public demand.

27. The export of gold from India on private account must be prohibited forthwith, and the import of gold must be confined to the Reserve Bank only. The Reserve Bank must import gold in such quantities as may be estimated to correspond to the demand for it for private use, and must have a statutory obligation to sell it to the public at a price to be fixed from time to time as a normal practice.

28. For purposes of national economy, the whole of the national wealth can be used, as the basis of credit, and may be used for many more purposes than hitherto. The credit structure has hitherto been based entirely on private initiative, with the result that much capital, which could have been itself used, has been lying idle, much cash is circulating at a low velocity and a much larger credit structure for financing increased operations in volume, which a careful planning of the wealth of the country could have secured, has not been secured in the past. Efforts towards this end should be made through the central banking authority. Large inducements should be held out to all, who have got resources not immediately spent or intended to be spent, to make these resources available to the banking system of the country for larger national use. Where inducements do not prove adequate, a measure of mild compulsion will have to be devised. It is too early and too premature to formulate such measures. Credit has to be created when the use, to which it is going to be put, is already there and has matured. Any earlier paper programme might actually do a lot of damage by shaking confidence.

29. In not recommending any immediate major changes in the monetary system of the country, the principal ground, which has deterred us, has been the desire to keep off cheap expedients and short cuts (being the convenient use of the printing press in one of its numerous forms) which will immediately raise the resources, only to cripple them after a short time. It is easy to generate speed in a vehicle, but not so easy to invent the necessary brakes, which will be effective and which could be applied as and when it is desirable to do so. Financial breakdown brings in its wake a complete paralysis of the economic machine, and it is the poor who always

suffer more from the result of such breakdowns coming through unwise experimentation with the medium of exchange.

30. The weakness of the primary producer with regard to his holding power for commodities leads him to sell off his produce at low prices and at a moment when there are other sellers competing. This is entirely unnecessary. It looks natural, because that has been the order of things in the past. In a well Planned Economy, it should be possible for the primary producer to hold out as long as he likes. This will mean the sale of produce, not all at once, but in small chunks or doses. It will enable the primary producer to get better prices. It would weaken correspondingly the strength of the middlemen and the distributors. Towards this end, it is recommended that warehousing facilities should be created, at as many centres as practicable in which the commodities will be placed on safe deposit, and the state will issue a warehouse receipt. If it is at all possible, the charges in connection with these warehouses should be eliminated and borne by general revenue. If that cannot be done, they should be kept down as low as possible. Simultaneously, the expansion of credit contemplated in other parts of this report must enable parties holding werehouse receipts to raise moneys on these receipts freely to the extent of almost, but not, the whole value of the produce. It is wellknown, by experiments elsewhere in the world, that the market will seldom fall below the rate of advance, which the State has fixed. In fixing a fairly high rate of advance, of the total value, the risk, which the State will take, would be relatively small and even where, after due notice to the party, who has taken the advance, or on his default the produce is sold off, neither the State nor the producer would stand to lose anything appreciable. A greater amount of carry-over would be then possible, but not at ruinous rates, both as to interest and charges and as to middlemen's profit, as at present.

31. We do not suggest that there should be any general scheme of price control either in the wholesale or in the retail markets. In section 24, a suggestion is made for the Central Banking Authority to maintain index numbers fashioned in different ways and in public interests to so adjust the machinery of currency and credit as to prevent widespread or extensive fluctuations. In other words, a general stability should be aimed at in the wholesale market, which will be good for the producers and which will destroy opportunities for the creation of speculative gains and other unduly large profits to merchants and distributors. With regard to retail prices, there is a racket, from which the poor are suffering in

India both as to quality, weights and measures and to the price charged. In order to eliminate this evil, or to reduce it to the smallest proportions, it is recommended that all retail dealers must exhibit in bold characters the price, which they propose to charge. In other words, all shops must be compelled to have fixed prices. A recommendation with regard to weights and measures is emanating from the Manufacturing Industries Sub-Committee, and must be strictly enforced, and endeavour should be made to see whether the retail price of an article could have some basic relation with the wholesale price of that article, so as to put a limit to the charges which the middleman can make. But, in view of the extreme generality of articles, and of different local conditions prevailing in different places, particularly with regard to rents, salaries and other charges, it is difficult to indicate a definite scheme of universal application, but power should be taken by the State to check profiteering, and any serious cases thereof, which come to the notice of the State, should be dealt with. In other words, the interests of the consuming public must be safeguarded.

32. Consumers' Associations are donig useful work in other countries, as providing a central ground, where information with regard to unfair treatment by retail merchants is pooled and spread out amongst the members. The establishment of such associations in all urban centres is recommended with a view to enable a body of public spirited men to collect the necessary information and to bring it to the notice of the controlling authority for suitable action.

MINUTE OF DISSENT OF PROF. K. T. SHAH

Regarding paragraph 4 of the draft report, I wish to dissociate myself completely with the sentence "The Indian Directors have failed to show initiative or power for withstanding such policies in India's interests." In my opinion it is neither correct in fact nor proper in taste.

Regarding paragraph 12 of the draft report, in my view under a system of Planned Economy, all inland remittance charges of every description should be abolished. Banking should be developed and facilities offered by banks provided on a scale and under conditions sufficient to make these facilities easily accessible to the average producer in agriculture and industry in this country. This can best be accomplished, in my opinion, by the widest possible development of the Postal Banking facilities, and the introduction of such systems as the Postal Cheque or the **Giro** system, which have been widely practised in a number of continental countries with excellent results.

Regarding paragraph 31, in my view a constant and careful control of prices, both retail and wholesale, is as necessary as it is unavoidable in a system of Planned Economy, if the very idea of planning is not to be frustrated. It is not enough merely to organise a machinery which would "prevent widespread or extensive fluctuations". The Planned Economy would not necessarily aim at mere "stability", but would, as I conceive the matter, regulate prices in such a manner as to be in harmony with the requirements of the Plan. And the Plan itself may have occasion, during the course of its being carried out, to lay varying emphasis on the different sectors of the National Economy, which may, therefore, involve varying the price level in accordance with the requirements of the Plan. The proposition, therefore, "that there need be no general scheme of price control either in the wholesale or in the retail market" seems to me to be incompatible with the idea of Planning.

NOTE TO THE INTERIM REPORT OF THE CURRENCY AND BANKING SUB-COMMITTEE

By

PROF. K. T. SHAH

Regarding the currency section of our report, one of our members feels that the approach to the problem of a sound currency system, appropriate to the Planned Economy, would have to be radically different from the one adopted in the report to the Committee as a whole. He would, therefore, like to point out that—

1. Money, in planned economy, should be confined to the original purpose of its first invention—viz. a tool of commerce, and not a tyrant.

2. A tool of commerce, to be efficient and serviceable, must have no other function which is calculated to pervert or defeat this original and primary function in the working of a community's economy.

3. Hence, except serving as a medium of exchange and a measure of value, money should not have any other function, like serving as a standard of value, or store of value.

4. If money is also to serve as a standard of value, with particular reference to its use as a measure of value, it must nevertheless be confined to value in exchange for the time being. It must be so ordained, regulated and controlled, as to be open to automatic adjustment to the changing needs of a community's economy, and its varying emphasis on any particular sector of that economy. Money, in other words, even if allowed to serve as a standard of value in exchange, must not be suffered to become a universal store of all values.

5. A standard of value, to be a real, useful and efficient standard, must be such as would be easily intelligible and acceptable to the commonest intelligence, and yet not one which would be of permanent character embodying some adventitious utility in itself, which would lead to the material selected to serve as standard becoming the dominant factor and governing principle of a community's economy.

6. Money should, accordingly, not be made out of any single commodity for all time, whether it is to serve as a simple medium of exchange, measure of value, or even as a Standard of value. It should preferably be made out of a number of

commodities of everyday use and general utility, whose relation **inter se** in exchange is a common phenomenon of daily life to the mass of the people. This relation need not be an invariable constant; but it must arise out of conditions of production and consumption which are fairly stable and generally understood.

7. For the sake of greater simplicity in daily transactions, any one or more of such commodities of general use may be selected to be a basis. Notes may then be issued by a Central Authority in terms of such a commodity or group of commodities in varying denominations. These notes may be ordained to be legal tender for all exchange transactions; and should be so designed, regulated and put into circulation, or withdrawn from it, as to serve absolutely no other function or purpose but the one of effecting an exchange. Like the postage stamp a currency note must be open to being cancelled after it has performed its functions.

8. If the commodity selected for such a basis is changed from time to time, there will be no temptation to use this material as a common store of value.

9. Money being made out of—or based upon—a number of commodities of every day use, the relation between credit and money should be the same as that between the commodities forming the basis of money, and the total wealth of the country. (Wealth is here taken to include both capital wealth, and income wealth.)

10. Credit must be organised and provided as a public service, and not as an individual obligation, indulgence, or privilege.

11. The basis of credit is the totality of the wealth of the community, and must be regulated, conditioned and supplied so as to promote the production and movement of such wealth as rapidly as feasible.

12. Price is an expression of the relation between the cost of production and the conditions of consumption of any given commodity at any given moment. In a Planned Economy prices would not be automatic adjustments and self-acting ratios, determined by the laws of Demand and Supply; but will be laid down, from time to time, by the central price-making organisation of the community, in accordance with the varying and different needs of the several sectors of the Planned Economy.

13. Local prices may be different from those for foreign markets; but the variation between wholesale and retail prices must be minimised as much as possible.

14. The foregoing is intended for money serving as medium of exchange within the community only, but the principle may serve also for regulating foreign exchanges.

15. No transaction of foreign commerce or foreign exchange should, if this principle is adopted, be permitted, except through a central banking organisation set up for the purpose. This does not necessarily mean nationalisation of the foreign trade of the country; but rather its co-ordination and centralisation for purposes of financing, so as to avoid any unnecessary strain upon the internal or external value of the currency system of the country. All banks operating in the country under the terms of a licence would be required to settle their foreign exchange transactions, if any, through the medium of the Central Banking Organisation or its department dealing with foreign exchanges. The best organised system of planned economy is liable to be upset completely by the forces working through the foreign trade of such a country, unless the entire system, including the foreign trade, is co-ordinated and centralised as indicated herein.

16. The foreign trade of the country may, however, have to be nationalised in proportion as the planned economy is achieved. Pending its complete nationalisation, there must be a progressively increasing control and regulation of its character and contents, direction and nature, where necessary by appropriate commercial treaties.

17. There is no intrinsic benefit in striving after "stability of prices". There should be thought given to "prices in the long run" as price is essentially a fleeting phenomenon.

A CURRENCY FOR INDIA

By

MAURICE FRYDMAN

In the beginning, articles of human need were simply bartered and the rate of exchange depended on the relation between demand and supply. With development of the agricultural life and trade the necessity of standards of value arose, and it is remarkable, that the first standards were based on articles of immediate necessity: grain, cattle, cloth. Further development of trade created a need for an easily portable standard and first metal in general and finally gold was adopted. Adoption of a gold standard used at that time for jewellery and vessels only, concides with a very high degree of general prosperity, when the demand for articles of first need was satisfied to a great extent, and when trade was catering to big towns and courts. Political development introduced State treasuries and a problem of replenishing them—large payments had to be made and this led to standardised metal pieces, called coins. Kings, usually badly in need of means of payment, manipulated with the coins, and their value decreased steadily, or in other words, prices were going up. Development of banking introduced paper values, which later developed into paper money by the same process of State manipulations. Ultimately paper money has replaced gold coins everywhere and gold has become now an article of trade, like any other, while currency and prices are ruled mainly by legislation.

The tradition of basing the value of paper money on the amount of gold the State will pay on demand is becoming more and more obsolete. There are very few States that will freely give gold to their citizens in exchange of paper notes. In international relations payment in gold is still current, but the general tendency towards balancing the imports and exports whenever possible by means of commercial treaties or currency depreciation has for its main purpose the elimination of gold from international relations.

The fallacy of gold as standard of value can be well shown if we take an extreme example.

A country called **Eldorado** is lined with gold bricks, but is, apart from this, completely barren. Its inhabitants will pay with gold for war material to protect themselves and

other goods to maintain themselves. The gold received in payment by the countries producing goods will be stored up in bank vaults and paper money issued to finance industry and agriculture to produce more goods demanded by our **Eldorado.** Provided the supply of gold bricks is big enough, the **Eldorado** State will flourish without producing anything, while other States will slave for it. The accumulation of war material may even lead to a political supremacy of **Eldorado** and all because other States have a fancy for hoarding up gold in their treasuries.

This may be an indirect test, but direct tests also show the unsuitability of gold as standard of value. The history of the last few hundred years of the West is a history of mankind suffering from gold poisoning. The production of gold does not go parallel to the development of the means of production and this leads to deep anomalies in the world trade and to periodical depressions. To consider them as natural would be to consider periodical attacks of malarial fever natural. They are signs of disease, of lack of balance between production and consumption, in short, of an unsound currency system.

The gold standard is also not moral in the sense of interfering with the self-evident right of every individual to self-expression. The shifting of the centre of gravity on a substance which is not an article of immediate and universal need has dislocated the attitude to life of the average man. Possession, and not service has become the goal. Everybody wants to have something, and not to be something and to do something. The harm, such mental distortion of outlook is doing to the individual and society cannot be over-estimated. Imagine the cells of your body obsessed with the idea of getting fat; some tissues, capable of collecting fat will become monstrously obese, while others, the brain and the nervous system first amongst them, will suffer acute emaciation. The bankers of the system, the heart and the liver will accumulate fat and will work lazily, which will lead to still bigger deposits of fat in some of the tissues.

To say that the same happens in our present-day society will not be an exaggeration.

To improve matters a change of attitude towards money is necessary. Gold is a static standard, it encourages possession, and not production and consumption.

Enormous amounts of human effort are spent on digging out the gold from one pit, called "mine" for putting it into another pit, called "bank". Since gold does not satisfy human

needs, it stands to reason that the labour is a complete waste. As a matter of fact paper currency could be issued on the basis of the gold content of the soil of the country with the same effect.

The very chemical stability of gold, praised by its partisans is rather a drawback. A depreciating currency would be infinitely better for the general welfare. But a depreciating currency alone would not be sufficient.

We do not maintain that currency reform alone will heal all wounds. It is not possible. Currency is only a tool, a technical detail of social organisation; but the right choice of a tool may have a far-reaching influence. Give mankind a standard of value that favours accumulation—it will accumulate. Give it another standard, that will encourage production and consumption—it will produce and consume with the same enthusiasm.

In our search for the most suitable form of currency for India we shall take the country as it is, and not as we would like it to be.

The main problem of India is the problem of a most appalling poverty, probably even worse than in China. One-fifth of humanity is living on or below the mere level of subsistence. The average income of an Indian is 7 ps. per day.

Poverty canot be abolished by State or private charity, however generous and extensive. One may be fed on doles, "Winterhilfe" "Soupes popularies" or "National relief funds" and yet remain in the same state of wretchedness. All the unemployment schemes, etc., are nothing but production of beggars on a mass scale. Workmen dislike intensely these schemes; unearned bread is tasteless for them. They postpone physical starvation, but mental and moral starvation remain the same. Vast millions are reduced in their human dignity and their capacity for work is wasted.

In India no unemployment or poverty-relief is yet organised. It is natural because poverty and unemployment are too general. Contrary to other countries, total employment is the privilege of a minority here. The vast majority of the population is partially or totally unemployed. All the resources of the employed part of the population will not be sufficient to finance even the most modest unemployment scheme.

Complete abolition of poverty involves a thorough economic reconstruction of which a currency reform is a single aspect only.

Whether it will take in India the shape of a State socialism, or of a God socialism, it is not for us to venture an opinion.

Thus, the system of currency we are in search for, should be designed so that its working automatically tends to diminish poverty, in other words: (1) It will favour production; (2) It will facilitate proper distribution; and (3) It will encourage consumption. Apart from this the proposed currency should be easily understood and accepted by the poverty-stricken man himself, i.e., it cannot be an abstract currency, based on price indexes or other statistical averages.

In looking through the list of human needs we find that the first is food. Its importance is out of proportion to any other. In moments of distress the satisfaction of all other needs will be sacrificed for the sake of food and family affection only proves sometimes equally strong. Food being the first necessity it is also the biggest single item of man's production. More effort is spent on the production of food than on everything else taken together. Food is also the item in which insufficiency of production, distribution and consumption is most intolerable. It makes the availability of all other necessities of life worthless.

Let us imagine that by some magic, India is deprived of all amenities of civilisation but given an abundance of pure and healthy food. A nation of well-built nudists, walking briskly from Rameshwaram to Badrinath for a stroll, begetting sturdy little boys and girls in a happy promiscuity, worshipping, if at all, **Sri Annapurna** only and friendly to each other because there would be absolutely no reason for being otherwise, may look grotesque to our worry-eaten minds, but whoever loves man for his own sake will not deny that it would be an acceptable proposition.

Food being the first and by far the most important need of man, which, when required, will be willingly exchanged against anything else, the following idea occurs immediately.

Why should not the most common and urgent necessity be made a standard of value? Will it work better? Will it fulfil the requirements of India? Will currency based on a food standard be the "morally sound currency" system for India?

The first thing to note is that a food currency is not a new idea. It exists and works on a small scale in all purely agricultural communities. It still exists in the Indian village economy. It is in harmony with Indian traditions. It is in the very blood of the villager, and the villager is India.

In ancient times gold coins were stored by tradesmen, kings and temples; the villager knew paddy only. Till very

late even taxes were paid in grain and the only contribution to be paid in gold and silver were the homages offered to the ladies of the household.

The introduction in India of a foreign economic and industrial system has destroyed the village economy and ruined the very foundation of the country's prosperity. Everything had to be paid with money, with **rupees, annas, pies** and money has become a nightmare. Its value in terms of grain was changing constantly. Significant is the fact that the villager says :"so many measures of rice for a rupee" and not "so many rupees for a measure of rice". It is because he had to purchase rupees, and never rice. He had to purchase rupees for payment of taxes, debts, implements, cloth, etc. Yet, in his mind, grain remained the standard of value and not money, which he had to get to pay off all his harassers till the next season.

Let us now make clear, what exactly we mean by the term "food currency"; with its introduction, what would be its influence on the agricultural and industrial life of the country, in what way will it affect production, distribution and consumption and how will it influence Indian trade relations with other countries.

By "food currency" we understand a system of currency in which a staple food product of the country is taken as a standard of value. In India it will be a chosen variety of paddy and wheat. A certain quantity of paddy and an equivalent from the nutritive point of view, quantity of wheat will be chosen and called a rupee. To distinguish it from the old rupee the new rupee may be named **food-rupee.** For purposes of convenience the food-rupee standard may be so chosen, as to represent the value of a rupee in terms of grain at a rate most suitable from all points of view.

Legislation will have to be passed: (1) to convert all gold obligations; (2) to control the import and export of currency grains; (3) to open State granaries, (4) to fix once for ever, the quantity of currency grain in a **food-rupee,** (5) to fix the seigniorage levied by the State when exchanging currency grain for currency notes.

The seigniorage is necessary to avoid the Government to become a merchant in grain. It may be one to two annas in the rupee, which will allow a margin of profit to all big and small grain merchants that will continue their trade within the limits of seigniorage, similar to the gold brokers of to-day.

The State granaries do not need to be many nor very big, if free railway transport of State grain is introduced, every

station master may be authorised to issue food currency notes against currency grains and send the bags of grain to the State granaries.

Private hoarding of food currency notes will be prevented by proper legislation devaluing old currency notes, unless deposited in savings banks.

An additional legislation of immense importance, although not directly connected with the currency reform would be the transfer of a part of land revenue to a Crop Insurance Fund, out of which compensations for total or partial crop failures will be paid.

Let us now visualise the change as clearly as we can. We shall assume that the reform is already about 3 years old, and the storm of protests, declarations, petitions, resolutions and interpellations has subsided and the big grain merchants have chosen another field of money-making, that the villagers have thoroughly learned the welcome news that there will be no more variation of price of crops, however abundant the crop may be and the grain consumer has also learned that he does not need to pay grain above a certain rate, printed on every currency note in his pocket. The grain ports are usually deserted. Apart from this not much more changes will be found in the towns.

The real importance of the reform will be seen in the village. Every plot of land becoming virtually a gold mine and every villager a gold digger, unusual activity is observable everywhere. Grain has verbally become money—by growing grain money is grown—and everybody knows well in advance how much money is going to be grown. Every piece of land is utilised, irrigation schemes are put to execution, the selected grain varieties are sought for, agricultural improvements quickly popularised, best implements purchased, every village humming with activity, because for the first time in history the grain grower is sure of the crop, its price, its market.

Demand and supply relations govern other agricultural products, and their culture will not be forsaken, as their price will be always controlled by the value of grain that can be grown on the same land with the same amount of labour and usually they bring some small premium to the enterprising grower.

Every villager knowing exactly how much value he is growing every year, is enabled to lay out a budget and to have his own private 5-year plan. The indebtedness of the village

has become possible to cope with, as the stabilised income of the villager has enabled the State to give long-term interest-free loans on the security of the crops.

The industrial development of the country is tremendously accelerated. The currency notes the villager receives for his grain he has either to spend or to save. He spends on industrial products like carts, bullock shoes, lamps, hardware, paper, etc. The amounts saved are utilised by the Government for financing big irrigation and electrification schemes, reclamation of waste lands, building roads and railways. In both cases the money goes to the industries. As the industries develop and their own costs go down, prices of industrial products in terms of agricultural products go down, enabling the villager to purchase more and more. Thus the development of industries follows closely the rise of prosperity in the villages.

The State has profited in several ways. Its land revenue is stabilised and growing from year to year. The seigniorage has created a new source of income. The prosperity of the population is increasing steadily, any local famine is dealt with by the Crops Insurance Fund, and there is plenty of reserve funds for any major scheme. Food, being the currency itself, no need of curtailing its production is ever felt; when abundant quantities accumulate in the granaries, extensive sanitation, town building and road building schemes are financed, educational facilities extended and children, maternity and old-age protection schemes introduced. Heavy inheritance taxes curtail the accumulation of too big savings, money is grown intensely and spent intensely and proper balance between production and consumption maintained all the time.

Except for the severe control of currency grains imports and exports, little change can be observed in the international trade mechanism. The **Food-Rupee** being an internal currency, the international trade accounts are cleared by a special bank agency which keeps foreign money and gold stock for smoothening out the differences between exports and imports. The country's gold production, useless now for the internal economy, is more than sufficient to meet any foreign obligation, if they have to be paid in gold.

Needless to say that although the food currency will make a tremendous difference in the economy of the country and may open a new era in its development, as long as the land will be in the hands of landlords, it will make them very rich and also very dangerous. The new scheme will benefit them in the first instance. The tenants, usually left with just enough

to live on till the next season, will get their benefits only indirectly, owing to increased demand for industrial and rural labour.

Yet any failure to give plenty to every individual in India will not be the fault of the currency system, but of other aspects of the present economic structure. The scheme by itself is able to foster production, facilitate distribution and increase consumption.

Can the reform be introduced immediately? Surely. It will make everybody's life easier. It requires a very simple legislation. It benefits the State and the citizen in the same measure.

Can it be introduced in a smaller area than the whole of India? Yes, provided two conditions are fulfilled:

(1) The chosen area can grow some excess of food over the needs of the population; (2) Its revenue is entirely independent and it has no outside charges; and (3) It has got freedom to regulate its imports and exports.

Some objections may arise and it will be useful to answer them in anticipation.

(1) Is it necessary to make food the currency itself? Will not a grain price policy based on State granaries do the same?

No, it will not do, as although it stabilises the prices to a certain extent, it will always be subject to the whims of the Governments and does not give the certainty, that the food currency itself can only give. Apart from this, the gold poison will not be eliminated.

(2) Will not a food currency lead to over-production of grain? No, because human needs are various and with the increase of prosperity the population will create a demand for other agricultural products, that will become more paying to produce, than grain.

(3) The food currency will foster barter transactions in the rural areas, with the elimination of currency notes.

It would be a welcome procedure, eliminating the middleman completely and giving to those concerned the full value for their services.

(4) It will be difficult to collect taxes in grain.

Taxes will be collected as usual, in currency notes. Exchange of grain against currency notes is done separately, preferably by the station masters.

(5) The State will incur heavy losses by accidental deterioration of grain.

The modern granaries can keep grain for very long periods. If the reform is passed by the Government, we undertake to design air conditioned and ventilated granaries in which grain will keep as long as in the Egyptian Pyramids.

(6) A heavy load will be put on railways.

Not at all; State granaries will not be big at all. The majority of grain transactions will pass through private hands, who will desire to profit by the seigniorage. Apart from this the increased railway traffic, due to higher prosperity, will pay off the railways generously the necessity of sending a train-load of grain free.

(7) Excess of grain will accumulate in State granaries.

Grain is a starting point in a variety of chemical industries. It can be dumped away by the State. A large percentage of currency notes issued will never be claimed to be exchanged for grain and the excess of grain can be sold to licensed chemical industries at lower rates or exported.

It is impossible in a single article to go into all the details of the scheme and to discuss all the corollaries. However Utopian it may look at the first sight, it is a simple, understandable scheme. It deserves consideration—and we are sure that a generation will come that will take it seriously and put it to practice.

NOTE ON REGUATION AND CONTROL OF FOREIGN EXCHANGES

By

K. T. SHAH

1. Recent experience has found that no country trading with other countries on any considerable scale is able to maintain on an absolutely uncontrolled basis the international value of its unit of money in terms of the currencies of other countries, not only because the foreign trade of most countries today is not free, but also the movement of funds between the different countries is a subject of so much regulation and control, that leaving the foreign exchanges of a community uncontrolled would only expose such a country to needless losses.

2. The Foreign Exchange business of this country has, in a manner of speaking, been regulated and controlled, at least indirectly, by the Rupee being linked to Sterling at a fixed ratio. Since 1893, when the Indian Mints were closed, and a gradual process of artificial scarcity of the Indian currency unit led to a steady appreciation of the exchange value of the Rupee, till it reached a point desired by Government as the reasonable ratio in or about 1898, the Rupee is supposed to be fixed in terms of Pound Sterling at 16d. to the Rupee, or 15 Rupees to the Pound. Government at first bound themselves to maintain this ratio on either end by giving freely rupees in exchange for gold at this rate, when the balance of accounts was heavily in favour of India, and the rupee was in high demand; and, when the balance of accounts went against India to give gold at the prescribed rate in exchange for the Rupee currency. A small fraction was permitted to cover the cost of remittance at either end of this fixed exchange ratio.

3. Sterling was, of course, taken to be synonymous with gold; and, as London was assumed to be a free market for gold, where gold and sterling exchanged freely at a fixed rate, it was felt unnecessary to insist upon any corresponding regulation of Sterling. The variations in the exchange value of the Rupee in terms of any other currency followed the fortunes of Sterling in respect of these currencies; and as most of the leading countries had their currency between 1899 and 1914

based upon gold, this implied a pretty stable level of international exchanges.

4. The gradual process by which the variation in the arrangement made in 1899 as regards the Exchange value of the Rupee and its props came to be modified need not be detailed at length here. In ordinary times there was always a balance of trade in favour of India, sufficient, not only to pay for the so-called "invisible" imports into India, but also to leave a surplus which was paid for in specie (gold or silver). This was formed into a reserve for use on the day when the balance of accounts might go against India, and the Rupee should depreciate in the international market. At first this reserve was kept in India mainly in gold, and called the Gold Reserve Fund. Silver needed for the coinage of Rupees was purchased out of this balance in favour of India, and the profits on the minting of Rupees was added to the reserve. Every rupee coined in those days meant a profit of 6 or 7 annas to Government; and as the balance of accounts in favour of India continued to be substantial, vast amounts of rupees were coined, and profits put into the Reserve.

5. After two or three years' experience of the working of this arrangement, it was decided to transfer a portion of the Reserve to London, as being the freest gold market in the world, where, whenever necessary, India could obtain her gold with the same ease and freedom with which other countries were supposed to obtain their gold deposited in London. Further, as Sterling was regarded as equivalent to gold, and as British Government securities were regarded as the best "gilt edged" securities in the world, a portion of the Reserve thus formed out of the profits of Rupee coinage came to be invested in Sterling securities. In the first big crisis before the world-war, namely 1907-08, when the exchange value of the Rupee threatened to depreciate, there was a forced sale of some portion of the Sterling securities in this Reserve at considerable loss. A loan was also needed to maintain the Sterling value of the Rupee at the fixed point.

6. This experience, however, did not serve to open the eyes of the authorities to the fundamental wrong of their fixed exchange system from the point of view of the Indian national economy; nor did it demonstrate the error of regarding gold and sterling as synonymous, or considering sterling securities as being as good as cash gold. A correlation was in fact established, in the years that followed, between the so-called Gold Standard Reserve, the new name for the old Gold

Reserve, and the Paper Currency Reserve, which was also kept increasingly part in gold, part in Sterling securities, part in Rupee securities, and part in silver and gold coin or bullion. By this facility it became unnecessary to buy silver and coin rupees every time there was balance in favour of India. A mere addition to the Paper Currency with an equivalent addition to the reserve would suffice.

7. The Gold Exchange Standard, which was the new name given to this arrangement, implied that the Rupee would be maintained at a fixed value in terms of Sterling,—not gold. Sterling was, of course, still taken to be equivalent to gold; and capable of being exchanged against gold any time when the exigencies of the international exchange market so required. Since a considerable amount of the Reserve was being built up year after year,—and kept in sterling and rupee securities, gold and silver coin as well as bullion,—in normal contingencies it was felt that a fair proportion of this Reserve would not be required for its primary objective, namely, the maintenance of the Exchange value of the Rupee. It was, accordingly, invested in ever growing volume in securities, which were assumed to be easily marketable without any serious depreciation. The bulk of these securities were securities of the Government of England. A growing proportion was also made up of Rupee securities, which was part of the Paper Currency Reserve.

8. The strain imposed by the World-War showed itself, first, in the form of an increased value of silver. The Rupee as a fixed weight of silver, also grew in value, and a steady, progressive depreciation of the Sterling in terms of gold, as represented by the American Dollar followed. The requirements of War led to India assuming considerable obligations on behalf of the British Government, for operations in the so-called "Near East". This more than set off the balance against India on account of the so-called "Invisible Imports". A considerable and increasing balance of exports from India over her imports, which were reduced substantially owing to the diversion of industry in the principal customers of India to war purposes, and because of the submarine menace, also led to the same result, namely, the stiffening of the exchange value, in terms of Sterling, of the Rupee. An attempt to maintain the fixed exchange value of the Rupee by introducing paper currency of lower and lower denominations, so as to spare the necessity of buying more silver and coining more rupees, which now left ever diminishing profits, did not quite succeed. Government were accordingly obliged to raise the

Exchange Value of the Rupee gradually, nominally to make for the greater cost of transport and Insurance of silver in war-time; but in reality because exchange was impossible to be maintained at the value originally fixed of 16d. to the Rupee, notwithstanding the pegging of Dollar-Sterling Exchange for the duration of the War.

9. At the end of the War, when European control over exchanges was removed, the depreciation of the Sterling in terms of gold, or of the American Dollar became more marked than ever. As the Sterling value of silver also rose, and as the Rupee representing silver became more valuable in consequence, the authorities responsible for the maintenance of the exchange value of the Rupee decided to fix a new level at two shillings per Rupee, on the hypothesis that silver had permanently improved in value in proportion to gold to this extent. The experiment, however, was disastrous, though Government tried for six months, by means of Reverse Councils, to maintain this new ratio. The consequence involved heavy losses to India, and depression of the reserves, which would otherwise have been built up.

10. By the end of 1921, or early in 1922, the Rupee once more returned to its pre-war level in terms of Sterling. Sterling also gradually improved, and when the Gold Standard was substantially restored in England in 1925 at the pre-war level, —notwithstanding the differences in the cost of production and altered conditions on international trade and money market,—the position of the Rupee had to be reconsidered. Artificial scarcity in the supply of the Rupee and of the representative forms of currency in India led to a new stiffening in the value of the Rupee till it was brought to 18d. in the exchange market. At this point another Royal Commission on Indian Currency and Exchange advised and the Government of India fixed the exchange value of the Rupee, in terms of Sterling, now again taken to be equivalent to gold, notwithstanding intense opposition from Indian opinion to this change.

11. On the advent of the World Depression this position had already been shown to be inimical to the interests and demands of India's national economy. With Sterling itself breaking away from gold, the case for maintaining the same ratio, even in Sterling, of the Rupee became more than ever difficult to defend. Government, however, persisted in maintaining the fixed sterling rate, and practically killed the export trade of India by 1932. The balance of accounts was definitely and heavily against India; and so a heavy drain of gold set

in from India. This helped to maintain the exchange value of Sterling, though diminished considerably, at a fairly steady level. Indian trade became penalised, till it dropped to 1/3 of its old level, and the Indian producer suffered in proportion. The drain of gold also involved considerable weakening of the base for the credit system of India. The capital resources of the country also became reduced, and industrial advance checked, all because of this peculiar kind of control and regulation of the exchange value of the Rupee in the interests rather of the British public economy, than of India's.

12. The lessons learned from this brief history of the Exchange policy of the Government of India may be divided into the following main categories:—

(i) Automatic adjustment of the exchange value of the country's monetary standard in terms of gold is impossible in these days of universally controlled international trade and regulated exchange.

(ii) Sterling is not, and cannot be considered to be ever likely to be equivalent to gold, in matters of International Exchanges. Conditions of production and trade in principal country have altered radically; and London is no longer the central money market of the world, or a free centre for buying or selling gold. It would, therefore, be fatal to India to link her national currency system to Sterling by fixing the exchange value of her local currency in terms of Sterling only.

(iii) If, as is evident from world experience, regulation of exchange and control of trade are inevitable in the interests of the country's national economy, that regulation and control must be in the interests of the country's own economy, and not for any extraneous reasons, such as those which have influenced the Indian currency authorities hitherto in the regulation of India's exchange policy.

(iv) Given the volume, variety and value of India's foreign trade, and notwithstanding the burden of the so-called "invisible" imports, India has sufficient strength of her own to regulate successfully the exchange value of the national medium of exchange from her own resources; and in conformity with the needs of her own national economy.

(v) The exchange value of the local medium of exchange has a close bearing on the internal level of prices in so far as it is influenced by international price-level; and consequently, on the degree of success open to the local productive organisation.

(vi) The price-level is made up of the inter-connection between the volume of currency of all forms,—including metallic money, paper money, and credit instruments used as substitutes for paper money,—and the volume of transactions needed to be carried out in order to run the aggregate economic organisation of the country.

(vii) For maintaining the price-level at a given point, we could operate on either side of the equation,—by controlling the volume of money acting as currency, as well as by controlling the organisation of production and consumption. In a planned economy both would be equally feasible.

(viii) The link between the paper currency and the metallic currency, as well as with the so-called deposit currency, and, therefore, the credit system of the nation, is thus of the strongest and closest and the most delicate; and would require very careful and constant control and regulation.

(ix) The different forms of money used under present conditions in this country are given in the Introduction and in the Summary of Developments.
A proper correlation is necessary to establish between all these forms and their use in carrying on the planned system of national economy in production as well as consumption.

(x) The authority entrusted with the control and regulation of this co-ordinated system must be in India, responsible exclusively and entirely to the Government of India, which, in turn, must be responsible wholly and solely to the representatives of the Indian people.

12. The Paper Money in India is expressed in terms of the Rupee, which is itself only a fraction of the Pound Sterling, which, in its turn, is a varying—and today a depreciated—quantity. Our Paper Currency is founded upon a cent per cent reserve, consisting of 40% of actual gold, and sterling securities, and the balance in silver—coined or bullion and

rupee securities. The following table shows the value of Paper Currency and its circulation and the constitution of the Reserve held against it.*

It is managed by the Reserve Bank of India since 1935. Previous to that it was managed by the Finance Department of the Government of India. The concentration of the currency and credit systems in the Reserve Bank of India, permits a closer link between the credit system, the currency system and the exchange policy of the country. But we cannot say, even now, that India's Exchange policy is run in the best interests of this country, and of this country only. So long as the Reserve Bank is a private corporation, however closely controlled; and so long as its conduct and management are outside the control of a Responsible Government of India, there can be no hope, no guarantee, that the Exchange Policy of India would be conducted entirely in the interests of this country only.

13. If the monetary system of the country is recast as suggested elsewhere, so that Money becomes purely and simply a medium of exchange, and a temporary measure of value,—without being an invariable standard of all values and much less a store of value—the regulation of its exchange value would be a relatively easier function. The most important consideration would then be to maintain the productive organisation of the country, and adjust it automatically to the consumption side of the national economy. A price-level may then be assured from time to time, which would permit of the disposal of the commodities produced on a basis of reasonable advantage to the producer and at the same time in accordance with the capacity of the consumer. The interests of the consumer would demand a price level corresponding to the cost of living, so as to be well within the means of an average consumer. In an organised social system of planned economy, however, the distinction between the producing and consuming interests in the country would not be quite so important, as every consumer would also be, directly or indirectly, present or potential, producer. What would benefit the producer in the first instance would not necessarily be antagonistic to the interests of the consumer. For an identity of interests, however, to be established between producers and consumers, the element of private profit, or surplus value monopolised by any class of the community, would have to be progressively reduced, till it is eliminated altogether. The variations in the

*For this see the Introduction and the Summary of Developments.

price-level from time to time would then be merely in response to the varying emphasis on the several sectors of the planned National Economy; and not in response to the insatiate search for private profit to the speculative entrepreneur. Nor would it be liable to be influenced as closely as today by every change of policy or economic influence affecting the price-level in foreign countries. It would also not cause that dislocation of the national economy which often happens under the present non-regulated system.

14. With a co-ordinated system of national control over the Foreign Exchanges of the country, no transaction in foreign exchange would be permitted, except through a national central banking organisation specially instituted for the purpose. The Reserve Bank may serve this object provided it is free to do foreign exchange business, has sole control of all available reserves, acts exclusively in Indian national interests, is responsible wholly and solely to the Responsible Government of India, and is a national institution in every sense of the term, in outlook as well as ownership, in conduct as well as control.

15. For a satisfactory conduct of India's foreign exchange business, it would be necessary that the entire foreign trade of the country with other countries should be financed through the Central National Bank mentioned in the preceding section. All Bills of Exchange and other documents of the kind should be domiciled with that bank in the ultimate instance; and the transaction represented thereby should be liquidated or carried out only through its agency. The Bank should deal with the corresponding Central Bank of the country with which a given exchange transaction has to be carried out,—or with which all exchange transactions in a given period are to be carried out. By this means the aggregate financing of the foreign trade of India with each customer country would be possible to conduct on a basis of the least use of specie for settling the final balance. The Reserve Bank may, if so advised, keep a given proportion of its balances in the liquid securities or commercial paper of the leading foreign countries not of one only; so that at times it may utilise these sources to avoid a needless movement of specie for settling international balance of accounts. By this process, the imports, into India, including "invisible" imports, will be set off against the Exports including "invisible" exports, between this country and any other customer country, and only the balance will have to be settled with each country and that would be very considerably reduced.

16. If an international clearing house is established,—as has already been foreshadowed in the creation of a Bank of International Settlements with its head-office in Switzerland,—the outstanding balance of accounts as between the different countries will be set off every year one against the other, in the same manner as in the clearing house in a given money-market all cross claims between the several parties are settled by mere book entries, debit or credit as the case may be, in the central banking institution serving such a clearing house; and no movement of specie need take place.

NOTE ON REGULATION OF MONEY & CREDIT

By

K. T. SHAH

1. Money, in planned economy, should be confined to the original purpose of its first invention—viz., to act only as a tool of commerce, and not as a tyrant.

2. A tool of commerce, to be efficient and serviceable, must have no other function, which is calculated to pervert or defeat this original and primary function, in the working of a community's economy.

3. Hence, except serving as a medium of exchange and a temporary measure of value at any given moment, money should be allowed to have no other function, like serving as a standard of value, or store of value. No single commodity can possibly serve as an ideal standard of value, which remains itself unchanged, in its relation to all other commodities or services changing in ratio constantly **inter se** mainly because of the changing conditions of the production and consumption of the several commodities and services. Only an abstract aggregate of all such ratios can, if at all, ever express a steady exchange relationship between the commodities and services forming the subject matter of trade.

4. On the other hand, if a commodity also serves as a store of value and a means of deferred consumption, it is likely to act so as to deflect the balance between production and consumption which is essential to maintain if a system of planned economy is to be carried out consistently and satisfactorily.

5. If money is also to serve as a standard of value, with particular reference to its use as a measure of value, it must nevertheless be confined to Value in Exchange for the time being only. It must be so ordained, regulated, and controlled as to be open to spontaneous and immediate adjustment to the changing needs of a community's aggregate economy, and the varying emphasis on any particular sector of that economy. Money, in other words, even if allowed to serve as a Standard of value in exchange, must not be suffered to become a universal standard of all values; and much less should it be

permitted to be a store of value, or means of deferred consumption at unabated or unaffected level.

6. A standard of value in exchange, to be a real, useful and efficient standard must be such as would be easily intelligible, and universally acceptable to the commonest intelligence. At the same time, it must not be one which would be of a permanent character embodying some adventitious utility in itself, which would lead to the material selected to serve as such standard becoming the dominant factor and governing principle of a community's economy, moulding and working it, not in accordance with the aggregate needs of the community's total economy, but rather in response to the needs or interests of those who own this money, or can control its volume and employment.

7. Money should accordingly not be made out of any single commodity of direct value in itself. It must not be intended to bear a fixed or steady ratio for all time with other commodities whether it is to serve as a simple Medium of Exchange, Measure of Value, or even as a standard of value. On the other hand, it must be so organised as to be of easy and universal acceptance and use for the one purpose for which it is intended and designed, viz., facilitating exchange of commodities from the producer to the consumer. It should, accordingly, be made preferably out of a number of commodities of every day use and general utility, whose relation **inter se** in exchange is a common phenomenon of daily life to the mass of the people. This relation need not be an invariable constant; but the variations, if and when they occur, must arise out of conditions of production and consumption, which are fairly stable and generally understood. For this purpose it would be necessary to construct an abstract standard or measuring rod, the so-called Index Numbers, compiled out of a number of articles of everyday use, selected on as wide a basis as possible, with all due weightage to each single item included, which must all be familiar to the people using them. This may next be represented in the form of a Currency Note expressed in units of the most considerable commodity in the list, which should be printed as a whole on the back of the note, and be made an obligation of the Central National Bank which controls the entire trade of the community at home and abroad, regulates the productive organisation, and generally supervises the collective national economy.

8. Currency Notes in this form may then be issued by the Central National Bank in terms of such a commodity in varying denominations. These notes may then be ordained to

be legal tender for all exchange transactions. They should be so designed as to serve absolutely no other function or purpose but the one of effecting an exchange like a cheque or a bill of exchange valid only up to a given date, or a postal stamp which is usable only once for a stated service and then cancelled. If the commodity selected for such a currency system is changed from time to time, and the exchange value of that commodity in relation to others is made a varying quantity, there will be no temptation to use this material as a store of value; for there will be no guarantee of the notes of any particular date, expressed in terms of any particular commodity retaining their relative value, or legal tender validity.

9. As a condition precedent and indispensable preliminary to this reorganisation, the Central Banking Institution of the community must have the sole custody of all reserves, and absolute control over all credit transactions, relating to commercial dealings between all classes within the country and with other communities. For this purpose, it must have sole charge of all valuta, all stocks of such materials as serve for money in any foreign community, and control and regulate their transfer from producer to consumer, and of all movements of 'capital' to and fro on account of the community.

It may be added that, for purposes of settling the international balance of accounts, we may adopt gold, or any other article accepted by the world in general as a medium to settle the balance.

10. This Central Banking Organisation of the community must necessarily be a nationalised institution of common interest and concern to all sections of the community. No transaction of foreign commerce or foreign exchange should be permitted except through this central nationalised banking organisation of the country; and all internal exchange transactions must eventually be settled finally through its intermediation as a final clearing house.

11. The foreign trade must be nationalised in proportion as the planned economy is achieved. Pending its complete nationalisation, there must be a progressively increasing control and regulation of its character and contents, its volume and direction, where necessary by appropriate commercial treaties. This must include all 'invisible' imports and exports which affect the country's international balance of accounts, and so react upon the international exchange value of its currency.

12. Pending the nationalisation of the Central Banking Institution of India, and completion of its monopoly of the

foreign exchange business of the country, a growing proportion of that business arising out of the foreign trade of India should be progressively secured for Indian banks. When it is so secured, it must gradually be transferred to the Central Nationalised Banking Institution as the sole operator in that field.

CREDIT

1. Credit must be organised and provided as a public service, and not as an individual obligation, indulgence, or privilege.

2. The basis of credit in a community is the totality of the wealth of the community. It must, accordingly, be regulated, conditioned and supplied so as to promote the production and consumption of such wealth as rapidly as feasible.

3. Individuals as such need not be concerned in the grant or use of credit. They must be organised in co-operative or collectivised corporations engaged in the production or distribution of any commodity or service, to which alone credit should be made available. When thus made available, it must be used for such purposes only as may be specified in the instrument of credit. In a system of properly planned economy there would be no need for private individual credit for any non-productive purpose which has hitherto occasioned the largest amount of indebtedness of the Indian producer.

4. Money being made out of index numbers based upon the average prices of a number of commodities of every day use, the relation between credit and money should be the same as that between the commodities forming the basis of money, and the total wealth of the country. Wealth is here taken to include both capital wealth, and income wealth, goods as well as services of all kinds, including administration and management, health and education, travel, amusement and recreation.

NOTE ON PRICES

By

K. T. SHAH

1. Prices are an expression of the relation between the cost of production and of consumption of given commodities. In a planned economy these ratios would not be determined by the so-called laws of Demand and Supply; but will be laid down, from time to time, by the central price-making organisation of the community, in accordance with the varying and different needs of the several sectors of the planned economy.

2. Local prices in regard to the same commodities, may be different from those for foreign markets but the variation between wholesale and retail prices will have to be minimised in a planned economy as much as possible.

3. The influence of the middlemen and advertising must be progressively reduced, and ultimately eliminated, as an unjustifiable tax for private benefit on the producer as well as the consumer. This will tend to keep prices,—wholesale as well as retail,—as near one another as possible.

4. There is no intrinsic benefit to the national economy in striving after "stability of prices". The Plan would itself take care of this matter. There should be no thought given to "Prices in the long run" as price is essentially a fleeting phenomenon.

NOTE ON REGULATION OF BANKS IN INDIA

By

M. L. TANNAN

The chief reasons for subjecting Banking to Government regulation should be evident to those who have given any consideration to the subject. In the first place, banking gives such a tremendous power as a result of its loaning function to those engaged in this business that it has been sometimes suggested that the state should have a monopoly of the same. Secondly, the whole structure of banking rests upon public confidence and once it is shaken the structure is liable to fall to the ground more so in a country like India in which joint stock banking is in infancy. Thirdly, as bankers carry on their business mainly with funds deposited with them and consequently they have a large proportion of the floating capital of the country in their hands, it is essential to regulate their business to minimise the risks of their failure. Fourthly, government supervision of banks is considered necessary on account of their close relationship with the economic structure of a country.

The Bank failure of 1913-15 clearly proved that it was unwise to apply the policy of **laissez faire** to Banking matters in this country and agreeing with this view the Banking Inquiry Committee recommended the passing of Banking Legislation. However, as the amendment of the Indian Companies Act was undertaken soon after the report of the said Committee was submitted, Government were content to provide some safeguards for the protection of the interests of the depositors and shareholders of banking companies by means of a few new provisions in the Companies Amendment Act, 1936, and thus the said recommendation was shelved. While it is true that the provisions referred to above are very useful they cannot, however, be taken to have done away with the need for a Banking Act. In addition to the provisions already made in the Indian Company Law and the Reserve Bank of India Act, legislation in the following directions appear necessary:—

1. It is generally admitted that some regulation as regards the capital of a joint stock bank is necessary and it is, therefore, provided in the Indian Companies Amendment Act, 1936, that no bank can start business unless it has a paid up

capital of Rs. 50,000. Additional capital should be required for every branch which a bank may open and its amount should be substantial in case of branches in Presidency towns. The Reserve Bank of India should be empowered to fix the amount in each individual case though some guidance in this connection may be given in the proposed Banking Act.

Moreover as the profits of every commercial bank depend largely on the amount of deposits it can attract it is but natural that the authorities of a bank would ordinarily try their best to increase its working capital by means of deposits. On the other hand, in case a bank suffers losses beyond its capital and reserve fund its depositors are bound to be hit. In order to provide certain minimum security to the depositors it is very desirable to lay down a minimum percentage which the paid up capital and the reserve fund of a bank must bear to the total deposits.

2. As the depositors of a bank provide 80 to 95% of its working capital and as they have no hand in the appointment of the statutory auditor, they should be allowed to appoint their own auditor as is the case with the policy holders of certain life assurance companies subject to the condition that the remuneration to be paid to such auditor shall not exceed that paid to the auditor appointed by the shareholders. It may also be considered whether the depositors of a bank should not be allowed to nominate one or more directors of a bank.

3. It is generally admitted that no great protection is afforded to the depositors of a scheduled bank by requiring it to maintain with the Reserve Bank of India a minimum daily balance equal to 5 per cent of its demand liabilities and 2 per cent of its time liabilities. It is, therefore, considered necessary that the scheduled banks should be required to have a certain minimum proportion of their demand deposits in government, semi-government securities or genuine commercial bills.

4. The need for distribution of risks necessitates a restriction on the powers of a bank to loan to a person or firm, company or corporation a sum exceeding say 10 per cent of its paid up capital and surplus. In case of bills maturing within six months and with two unconnected signatures the percentage may be raised to 15.

5. With a view to prevent commercial banks from locking up large amounts of money in properties it should be laid down that no bank other than a mortgage bank should hold immoveable property except that required for its own use or

shares in real estate companies for more than five years. Such properties as may be taken in settlement of bank dues should be got valued by independent valuers within 12 months after they are acquired and no income from such properties should be credited to the profit and loss account unless adequate provision for their depreciation, if any, has been made.

6. In order to prevent a bank from inflating its profits the law should lay down that in the case of accounts in which the actual payments, if any, during the preceding twelve months do not even come up to the amount of the interest debited to such accounts, the interest earned in excess of actual payment should be credited to Interest Suspense Account and not to the Profit & Loss Account. Amounts so credited should be transferred to the Profit & Loss account of the period or periods in which actual payments are made.

7. Every bank should be required to show in the balance sheet book debts for which suits have been filed or decrees obtained separately from other book debts.

8. Banks should ordinarily value their assets at cost or market value whichever is lower and in cases in which they are shown at higher figures than their cost, the same should be required to be stated clearly in the accounts to be presented to the shareholders.

9. Provision should be made for the periodical inspection of the accounts of the scheduled banks by the Reserve Bank of India which should be empowered to call for any information regarding the working of any bank in British India.

10. Among other causes responsible for the failure of joint stock banks in the country the absence of a sufficient number of suitable directors from bank boards is quite important. A bank director need not necessarily have a practical knowledge of bank but he should understand the fundamental principles of banking. He ought to know the importance of liquidity and safety of the assets of the bank. He should see that his bank avoids long term commitments. It should be understood that credit is to be given on a business basis and not on the basis of personal friendship or self-interest. Similar considerations should apply to the recruitment of staff. It is, therefore, necessary that before a bank is registered, the Registrar of Companies should satisfy himself that among the promoters of the bank there are persons suitable for being appointed as directors.

11. The Banking Act should also provide adequate protection to Banks against malicious attacks by spreading false rumours, etc.

12. With a view to simplify the liquidation of the failed banks and to bring to books those responsible for the infringement of the law or indulging in unsafe or unsound practices in their management it is desirable to entrust except in the case of very small institutions the work of liquidation to the Reserve Bank of India. This will also lead to economy in the realization of assets and a speedy winding up of the concerns.

NOTE ON JOINT STOCK

By

M. L. TANNAN

The main object of this note is to invite attention only to such important points as require consideration for the improvement of commercial banks in this country. Accordingly, I have purposely omitted to give any historical sketch or a description of the existing commercial banking which the Secretary of the Sub-Committee may be requested to furnish.

The financing of Indian Commerce is mainly in the hands of Indian Joint Stock Banks, Exchange Banks, and the Imperial Bank of India. According to the Statistical Tables relating to Banks in India the volume of deposits of the said three classes of banks on 31st December, 1934, was as follows:—

Class of the Banks.	No. of H. O.	No. of Branches	Total Deposits in Crores of rupees.
1. Indian Joint Stock Banks, with capital and reserve of Rs. 1 Lakh or more.	105	688	81.88
2. Exchange Banks.*	—	98	—
3. The Imperial Bank of India.	3	160	90
Total	108	946	

*In the case of Exchange Banks only deposits with their Indian Offices are given.

In 1934 the total number of banking offices in India was 1269 against 25,000 in U.S.A., 13,200 in Great Britain and Ireland, 4,500 in France, 3,400 in Germany and 1,300 in Belgium. There was a banking office for every 276,000 persons in India as against 3,056; 4,816 and 9,491 in the United States, Great Britain and Japan, respectively. Even taking into account the important part played by the indigenous bankers it is generally conceded that there is ample scope for the expansion of the Joint Stock Banks in India. The absence of banking facilities coupled with the lack of education among the

masses must, therefore, lead to the age old habit of hoarding and temporary locking up of funds amounting to large sums which otherwise would be available for the development of credit facilities. Among the causes mainly responsible for the slow progress of joint stock banks in India attention may be invited particularly to the following:—

1. Indian Joint Stock Banks receive little or no encouragement from Government, Public, and semi-public bodies such as the municipalities, Port, Trusts, Courts of Wards, etc., which do not ordinarily deposit their funds with Indian Joint Stock Banks.

2. The **laissez faire** policy of the government in the matter of banking in India is partially responsible for the failure of some of the joint stock banks which has affected adversely the public confidence in Indian banks.

3. The Indian Joint Stock banks suffer from the competition of the exchange banks which not only monopolize the financing of external trade of this country but also take a large share in the financing of her internal trade with deposits received by their Indian offices. The Indian branches of 17 Exchange Banks working in this country had on 31st December, 1934, deposits amounting to Rs. 71.40 crores against 81.88 crores in the hands of 105 branches of Indian joint stock banks with a capital and reserve of rupees One Lakh or more. Moreover, complaints have sometimes been heard that not only do some exchange banks refuse to give proper replies to inquiries made by Indian banks regarding the credit-worthiness of some of the parties having previous dealings with those exchange banks but also to the effect that they run down certain Indian banks. The Indian joint stock banks have also suffered from the competition of the Imperial Bank of India due to its government support.

4. As a large measure of the trade and industries of this country is in the hands of the non-Indians, the Exchange Banks naturally receive preference over the Indian Banks.

5. The working of many Indian Banks suffers from many drawbacks, such as inefficient service, the absence from the Boards of Directors, of good businessmen and financiers having adequate business experience and good credit to inspire public confidence in those institutions, mutual jealousies and want of reliable agencies, cut-throat competition among Indian joint stock banks, locking up of large sums of money in landed properties, etc., etc.

Before considering the important steps to be taken to enable the Indian joint stock banks to play their proper part

in the financial organization of this country it will not be out of place to observe that the absence of a national government in this matter as in many others is bound to hamper the progress of Indian banking. It is but natural that in matters in which the interest of one's own country happen to clash with those of another, one is even unconsciously inclined to give preference to one's own country. It is, therefore, evident that the change in the government will automatically provide great encouragement to Indian banks. The following measures appear to be necessary for the development of Indian banking on sound lines in this country.

1. While on the one hand the government should provide the regulation of banking business by means of a comprehensive Bank Act* which will strengthen public confidence in Indian Banks, it should on the other give every encouragement by giving preference to good Indian banks in the matter of deposits of funds belonging to Port Trusts, Municipalities, Courts of Wards, educational and other institutions receiving government aid, granting of remittance concessions and exemptions from stamp duties and registration fees as given to the co-operative banks, extending facilities of borrowing money by equitable mortgages to large cities other than three Presidency Towns and Karachi and by removing defects in the existing laws regarding succession to and transfer of rights on immoveable property belonging to certain sections of Hindus and Mohammedans. Banking legislation should in itself not only protect the depositors and shareholders from unscrupulous banking management, but also secure the protection of banks themselves from unjust attacks on their stability, though the right of the public, the depositors and the shareholders to a fair criticism of the management must be carefully guarded.

2. In order to encourage Indian Joint Stock Banks to open new branches, the Reserve Bank of India should offer to deposit a certain amount with every new branch opened in a town without a commercial bank, by an approved joint stock bank with the previous consent of the Reserve Bank of India for a given period on such conditions as it may consider necessary to lay down and provide rediscounting facilities at special rates.

3. The Reserve Bank of India can further help the joint stock banks in this country in forming a Bankers' Association with the following objects:—

(a) to develop the practice of 'one man, one bank';

*Please see the note attached herewith.

(b) to arrange for the pooling of information regarding the credit of borrowers in different parts of the country and to create if necessary a special organization for the purpose;

(c) to create an **esprit de corps** among banks working in this country and to take suitable action in cases where some banks are found guilty of spreading false rumours about other banks.

(d) to encourage certain uniform practice in the best interests of the banks and the general public.

(e) to make representations to government, the Reserve Bank, and public or semi-public bodies and to take such steps as may be considered necessary in the general interests of banks working in this country.

4. The Reserve Bank of India should help the indigenous bankers, individually or in groups to form local banks, encourage the amalgamation of small banks, popularize the use of bills of exchange, increase the number of Bankers' Clearing Houses, and make suitable arrangements for the clearing of non-local cheques.

NOTE ON EXCHANGE BANKS

By

M. L. TANNAN

The British and other foreign banks working in India are known as the Exchange Banks because originally they entered into the Indian Banking field to finance foreign trade of this country. They occupy a very prominent position in the Indian money market. The banks have their head offices abroad. In the case of some of these banks such as the National Bank of India, Ltd., the Chartered Bank of India Ltd., and the Mercantile Bank of India, Ltd., a considerable portion of their business is carried on in this country, while in the case of others such as the Hong Kong Shanghai Banking Corporation, Ltd., the National City Bank of New York, The Yokohama Specie Bank Ltd., etc., only a comparatively small portion of their business is done in India. Not only these banks have more or less the monopoly of the foreign exchange business, but also they are formidable competitors of the Indian Joint Stock Banks in other fields of commercial banking in this country. At the end of 1934, these banks had no less than Rs. 71.40 crores of deposits in India, as against Rs. 81.88 crores held by all the Indian Joint Stock Banks. The present position of the Exchange Banks is due to the following factors:—

1. Some of them came into the field early and established their names.
2. As the foreign trade of India is largely in the hands of non-Indian business houses, they not only prefer to give their own business to such banks but also encourage other merchants to deal with them.
3. Not only have they been from time to time allowed to do their business in this country free from any restrictions generally imposed on foreign banks working in several other countries, but they have also received indirect help even from government in this country.
4. The efficiency of their management has also contributed to their present position.

There can be no two opinions as to the detrimental effects of the working of the Exchange Banks in this country. Not only do these banks make large profits at the expense of this

country, but they discourage Indian enterprise in several directions. For instance, they help foreign insurance and steamship companies, British merchants, brokers, solicitors, accountants, etc. These banks are said to be diverting Indian capital to investments in foreign industrial and gilt-edged securities. They do not usually give responsible posts to the nationals of this country. Complaints have some time been made that the staff of some of these banks run down some Indian Joint Stock Banks.

In order to remedy the present position, it appears necessary to take steps in the following two directions:—

1. to divert the financing of the foreign trade of India from foreign banks to an Indian Exchange Bank to be created for the purpose.
2. to impose such restrictions on the foreign banks working in this country as may be considered necessary in her best interests. Undoubtedly, there are difficulties in the way of transfer of the foreign exchange business of this country from the hands of strong and well established foreign banks to an Indian bank, but they are in no sense unsurmountable more particularly if the government and the people of this country make up their minds to do so. With this object an Indian Exchange Bank should be started with the backing of the Government and the Indian Joint Stock Banks. The Government can help by giving for the first seven years a guarantee of interest on the preference capital to be raised for the purpose. Any amount so paid by the government to be repaid gradually out of the surplus profits of the bank after setting aside amount required for payment of dividend at 3½%. Government should also undertake to contribute annually a certain sum not exceeding 50% of the annual expenses of the bank during the first five years. Other concessions such as exemption from the payment of income tax, certain stamp duties, etc., may also be granted to the proposed institution. The ordinary shares should in the first place be offered to the Indian Joint Stock Banks in some fixed proportion to their paid up capital and reserve fund. An alternative to the above scheme which may be considered is that the Imperial Bank of India should with the help of government and Indian Joint Stock Banks start a subsidiary institution for this purpose. Details of the scheme can be worked out after the preliminary discussions of the proposals by the Sub-Committee.

Before dealing with the restrictions to be imposed on the Exchange Banks, it is necessary to emphasize the fact that the policy of the open door to foreign banks in India should be discontinued as has been unanimously recommended by the Central Banking Committee. It is therefore, necessary to introduce the system of licensing the foreign banks operating in this country as is done in some other countries. In this connection attention is invited to my 'Regulation of Banks in India (pp. 26-27).

While it is true that as recommended in the majority report of the Central Banking Committee, licenses should be given freely to banks which have been operating in this country, it is submitted that due regard must be given to the promotion of the national economic policy in banking. In the first place no new foreign bank should be allowed to start business in this country without the previous permission of the Reserve Bank of India and such permission should be given only after satisfying among other things that the country of its origin imposes no undue restrictions upon the nationals of the country. The existing foreign banks also should be required to obtain such licenses though in their case the licensing authority may be more liberal than in the case of new banks. Secondly the Exchange Banks should restrict their activities to the Indian Port towns only. Thirdly, they must undertake to supply to the Reserve Bank of India full information about their working in India, and to throw open to Indians even responsible appointments except such as those of managers, assistant managers or chief accountants. Fourthly they should undertake to employ funds received in India in business in India or for investment in Indian securities.

NOTE ON SAVING AND INVESTMENT

By

PROF. K. T. SHAH

I

1. The essence of 'Saving' lies in the creation or bringing about of an excess of the total volume of production over the total requirements of consumption, both taken collectively.

2. In so far as the individualistic economy prevails in a community in regard to all productive processes, it is impossible to organise satisfactorily 'saving', and collect or mobilise the same in a central place. The process of distribution will then be conducted somehow, so that, while each individual member's requirements for consumption are fulfilled, or the needs for the entire process of production and the maintenance of national economy are supplied, a surplus is nevertheless brought about, which can be utilised either as reserve, or for further investment in any direction, in which it may be necessary to employ such surplus for furthering the process of production. There would be no co-ordinated or planned system of utilising such savings for the furtherance of the prevailing economy. It would be a wholly individualist affair, without any plan or system or method except such as may be provided by the desire for private gain.

3. One of the greatest needs for rehabilitating India's productive organisation is generally believed to be the lack of necessary 'capital', or the tools, materials and buildings for production and maintaining labour while the process is going on. This is due to the absence of sufficiently co-ordinated and mobilised 'saving', which can be readily invested for purposes where it may most be needed. Capital, however, is another form of the amount of national wealth saved, or mobilised, and kept together to serve for investment or use in any direction in which such capital is needed in the opinion of the Planning Authority.

4. This lack is caused mainly by the absolute insufficiency of the aggregate production of material goods and services in the country needed for the maintenance of a reasonable standard of living, of the most modest character, throughout the country. It is partly due also to the faults of the system of distribution in the country as also to the absence of a sense of political security until very recent times, and the backwardness of the methods and technique of production.

There is no dearth of initial endowment for producing new wealth in the country. But our resources remain unknown or untried; or, if they are exploited, they are so for the benefit of non-Indians mainly. For creating the necessary surplus needed for the maintenance of a planned economy, at the pitch and in the tempo decided upon by the Planning Authority, it would accordingly be necessary as much to speed up the process of production, improve its equipment in tools and machinery, and organise the technique of production to the best possible advantage, as to modernise and rationalise the methods and principles of distribution of the wealth produced, so as to bring about an equitable and more even distribution of the national wealth.

5. Apart from the collective insufficiency of the surplus needed for constituting 'saving' sufficient to serve as capital for an organised and planned productive system, there may, of course, be savings in individual instances, which, in their aggregate, may amount to a considerable amount. But this individual saving also need be conserved and organised, as well as mobilised so as to serve the purpose we have in view, namely intensification of the process of planned production, including modernisation of the instruments and technique of production and speeding up the tempo of the planned economy of this country.

6. At the present time, under the co-ordinated provisions of several pieces of legislation, it is incumbent on Joint Stock Companies engaged in any productive process, or in any service ancillary to production, to set apart a certain proportion of the excess of their receipts over outgoings to form a reserve. This reserve may take the shape of specific provision for depreciation and replacement of the machinery and other equipment required for production; or it may be a provision for maintaining a certain even rate of profits or dividends; or again it may simply be undistributed profits maintained as the first reserve of such a corporation.

The method of deliberately writing down the assets for purposes of preparing balance-sheets and profits and loss accounts will help to create such secret reserves. It is necessary that such legal provisions be made more stringent while the individualistic economy lasts, so as to make the maintenance of such reserves legally indispensable in all enterprises engaged in the process of production, whether in industry or agriculture, or in services ancillary to these processes, or in the so-called public utility works whose products or activities are capable of a commercial disposal.

7. The law must also provide for the instantaneous mobilisation of these reserves as soon as they are formed, and

require their maintenance in as liquid a form as possible. They must also be required to be deposited in some central institution charged with the control and utilisation of such resources of the community, so that even when the planned economy comes into operation, these reserves may be available for utilisation in any direction that the Planning Authority may decide upon.

8. The same applies to another class of reserves or 'savings' which are brought about by the Corporations or institutions engaged in Insurance business. The funds of these bodies are obviously of the nature of saving proper, set apart by the individuals doing so, and entrusted to the Corporations receiving them, with a view to protect the insured individuals against the particular contingencies insured against. The aggregate of these funds, after allowing for the losses or expenses payable out of these, would also need to be compulsorily mobilised, so that the total volume of the nation's savings, or capital available for further employment in productive direction may be increased.

9. The institutions definitely and specifically devoted to the collection of individual savings and their utilisation in the most economical manner, namely banks, have in this country conceived their mission in a somewhat restricted manner. Conventional banking is still regarded in this country as consisting of services to commerce, both internal and external, which admits of quick turnover, and, therefore, profits at a very low rate. Banking with a view to assist the productive process and organisation in the country, whether in industry or agriculture, needs yet to be created in this country on a national scale in proportion to the requirements of a planned economy. The existing land banks or mortgage banks or those concerned with agricultural co-operative credit, are all working on a very limited scale; and under considerable restriction it makes it impossible for them to aid substantially in the process of production. They deal mainly with small producers, concerned with operations on a very limited scale and whose margin of income is so small, that ordinarily no saving is possible in their case on their own books.

10. In addition, there is the constant fear and overwhelming weight of Indebtedness, which besets the agriculturist and small scale producer in rural districts. Almost the entire volume of this debt is of an unproductive character, and acts as a deadweight upon the national economy. One of the first steps indispensable for the proper execution of the Plan, would accordingly have to be a compulsory registration of the amount and conditions of agricultural indebtedness, under which the Indian agriculturist and countryside producer has

to labour, to the immense disadvantage of himself as well as the country. These debts carry an incredibly and unconscionably high rate of interest which further reduces the potential margin of saving of the agriculturist and other small producer. Any process which aims at affording real, substantial and permanent relief to the indebted agriculturist would accordingly have to bring about a compulsory reduction of the rate of interest and modification of the other onerous terms connected with this debt. A special type of institution would accordingly have to be evolved and set up to deal with collection, registration and liquidation of the agriculturists' debts. The saving thus afforded would have to be utilised to create new reserves so as to aid in the process of production.

11. The savings thus brought about and mobilised from our resources will be useless unless the basis of investment and the directions for the same including the time and amount of such investment are also provided by the Planning Authority in accordance with the requirements of planned economy. If and when such savings prove inadequate,—as may quite possibly be the case for the requirements of India's planned economy in the next ten years,—it may be necessary to attract capital from abroad, on terms and under conditions which may be supportable by Indian enterprise. But, any capital thus attracted from abroad must also be under the direction of the Central National Banking Institution, so that the foreign capitalist should not exact a disproportionate toll from India's national economy because of the loan of his capital.

II

The total volume of savings available in this country, even as known at present, is difficult to compute exactly. The statistics of banks and banking in India indicate the total volume of deposits as follows:

In the Reserve Bank of India from Govt. Sources:	(about)	Rs. 11 crores.	(31-12-'38)
Other deposits from Banks:	„	Rs. 13 crores.	
In the Exchange Banks:	„	Rs. 75 crores.	
In the Joint Stock Banks:	„	Rs. 98 crores.	
In the Post Office Savings Banks there were about	„	Rs. 77.5 „	(31- 3-'38)
Deposits in the Postal Life Insurance System — an aggregate of 96 thousand policies valued at nearly:		Rs. 19.0 „	
Total		Rs. 293.5 „	

These do not exhaust the amounts which may be said to be representing savings in a fairly mobilised form. The various reserve funds in charge of the Government or of the Banks, including the Currency Reserve, public Joint Stock Companies, which are required by law to maintain a 'Reserve', and the funds of the Life Insurance Concerns, not to mention treasury balances, may also be included in computing the total volume of savings available in India.

Not all of these, of course, can be regarded as wholly available for purposes of industrial investment, or economic development of the country, much less for social services. But even if we regard half of these funds only as available for this purpose, we might find it would go a long way to meet the requirements of a carefully compiled Plan of National Economy. Such a Plan must lay down the order in which the progress of economic development in the country is to be achieved; which task of industrial as well as agricultural development would have to take precedents over others of the same species; what social services would need to be developed side by side, so as progressively to improve the standard of life among the people, etc. The capital that may then be required would not be impossible to meet from India's own known, or unknown, resources.

The aggregate of the known resources mentioned above, comes to 290 crores in round terms. Half of this amount may quite possibly suffice for the capital needs of a Progressive Plan, of national development and social reconstruction. On this basis it would lay our hands on at least Rs. 15 crores per annum for use as capital needed for the Plan every year for ten years,—the first instalment of the national programme, i.e., about 150 crores in all. Such investment, it must not be overlooked, will itself help to bring about new capital by producing a new surplus of production over consumption, and so the resources would be progressively improving.

In addition to these, there are secret and unknown resources which lie practically buried in the religious foundations, charitable trusts, temples, mosques, churches and so on, which are impossible to be used at the present time for purposes of the economic regeneration of the country, and the carrying out of a proper plan of national economy. Popular sentiment would need to be educated much more thoroughly on rationalistic lines to permit of such diversion of these funds. It is impossible to estimate the volume of liquid resources locked in such unproductive and unusable channels. They have been accumulating ceaselessly for centuries. A rough

estimate of these potential reserves seems to indicate that perhaps all the needs by way of capital for the industrial development of the country may be obtained from these sources alone, so that India may not have to go out and borrow abroad for this essential purpose of national life.

The volume of capital investment required for purposes of a progressive Ten-Year National Plan is likewise difficult to estimate exactly. Various estimates have, in fact, been made, which would indicate that the total capital investment of about 400 crores judiciously laid out would make this country not only self-sufficient in all matters of essential requirements but would also assure it a degree of prosperity and improvement in the standard of life amongst the vast masses of its population which would be well within the requirements prescribed by the National Planning Committee. The reports of the Manufacturing Industries Sub-Committee, of the Chemical Industries Sub-Committee, Engineering Industries, and other industrial and agricultural committees have yet to be submitted. They would put forward their own estimates and requirements of capital needed for the purpose of carrying out their section of the Plan of national economy; and these co-ordinated would constitute the aggregate sum needed for this purpose. Pending receipt and co-ordination of these, our recommendation must needs be tentative, or only illustrative. But the figures we have put forward above would go a long way to show, we trust, that the capital needs of India in respect of a Plan are not impossible to meet from her own resources.

It must also be remembered that all the capital required will not be wanted at once on the same day. The Plan itself is necessarily progressive, and its realisation developing year after year, so that, within the first instalment of the Plan proposed,—for ten years,—we would need, at a progressive rate, capital for investment in industrial and other economic development of the country perhaps not exceeding 20 crores a year. 20 crores per annum is not too much to expect from Indian resources alone even in normal times as the experience of the Government of India in floating loans for their relatively non-productive purposes over the last thirty years will show.

N.B.—Heads of Enquiry No. 10 and No. 11 are not submitted by the respective contributors.

NOTE ON GOVERNMENT BORROWING

By

MANU SUBEDAR

There has been a check on Government borrowing for railway purposes ever since railway finance showed adverse results. The following table will indicate:—

Year.		Net revenue.	Interest charges.	Surplus.	Total Rly. deby.
		(Figures in crores of rupees)			
1926/27	..	33.37	25.87	7.50	655.71
1927/28	..	38.12	27.27	10.85	668.59
1928/29	..	37.14	29.33	7.81	700.69
1929/30	..	34.50	30.46	4.04	730.79
1930/31	..	27.53	32.72	—5.19	743.98
1931/32	..	23.87	33.07	—9.20	750.72
1932/33	..	22.68	32.91	—10.23	750.75
1933/34	..	24.62	32.58	—7.96	754.94
1934/35	..	26.74	31.80	—5.06	755.63
1935/36	..	27.39	31.39	—4.00	750.04

It will be noted that a larger amount of borrowing came for Provincial Governments. In Government of India's finance, this is put down as productive, because the interest charges are borne by the provinces. In so far as the provinces are solvent, the interest will undoubtedly be paid, but, in the affairs of many provinces, much money, which has been raised, has been frozen. In some cases the capital would have to be written off. The most outstanding example is the Development Expenditure of the Government of Bombay.

It is obvious that, since the last war, Government borrowings is playing a much more important role than it did before. In other words, Government are taking up a lot of capital both for long-term investment as well as for short-term loans. This means that Government are competing with industry and commerce for money and, with the credit of the state, which is always superior to that of any private enterprise or individual, Government are in a position to have the pick.

What would happen if Government came for a much larger amount? To what extent can Government still increase their borrowings without sending up money rates, or without materially curtailing the resources available to trade and

industry? These questions require careful thought. There is not available at any time more than a limited quantity of loanable capital. There is some capital, which is awaiting long-term investment and which, while the decision is pending and while the accumulation is going on, is put in Treasury Bills or short-term deposits. There is some money, which must be put out on short period, such as current funds with banks, which are liable to be recalled at any moment, but the investments in Treasury Bills and other short-term Papers, would go on at the hands of the banks, if the funds are not so recalled.

The amount of money awaiting disposal has increased in India on account of new types of business having come into existence. The growth of joint stock enterprise, for example, involves the making up of accounts once in the year and the disposal of the profits, which accrue every month, occurs only after the accounts are prepared and few months after the close of the year. The growth of the banking habit is also responsible for the break-up of the so-called private hoards or cash, which were kept by money-lenders and by shroffs all over the country. Much of this money finds its way into the banks now in current account. While the resources of the banks in this manner have increased for immediate investment on the one hand, Government have taken up a lot of these on Treasury Bills and short-term borrowing. There has not been, therefore, an increase of money rates and there will not be, so long as the demand is not in excess of the supply.

Another direction, from which the increased borrowings of Government in recent years have been satisfied, is the investment of life insurance companies. The law now rigidly compels them to put their premium reserves in Government loans or Trustee securities. Automatically, as the business of insurance grows in India, large funds are released for this purpose and are absorbed by an increasing amount of capital taken off by Government from the market. Had Government not increased their loans, these funds would have driven the money rates down in India.

The artificial reduction of bank rate in India following slavishly the policy in the United Kingdom, has had serious consequences. A 3% bank rate does not reflect the millions of transactions of loanable capital, which are done all over the country between borrowers and lenders. But a 3% bank rate has the effect of reducing the deposit rates by banks. At the expense of the depositors, therefore, the banks have made money. The reduction of rates offered by banks to depositors had also the effect of driving some of this money into the field

of Government loans. This artificial stimulus to investment in Government security cannot last, and the whole problem of money rates in India will have to be settled, so as to reflect more correctly the economic conditions than has been done hitherto.

The advent of popular Ministries has compelled popular Governments to come on the market and though there is, as there ought to be, a salutary regulation that they will not compete with one another, or make a scramble for money, the borrowings of popular Governments on Treasury Bills have been at a higher rate than the borrowings of the Central Government for Treasury Bills. Similarly, in long-period loans, there has been a difference of not less than half per cent—but in some cases as much as one per cent—between the borrowing of the Central Government and that of the Provincial Governments. This is a disadvantage to India as a whole, as it imposes a larger burden on the tax-payer, who is the same party both for the provinces and for the Centre. By a reorganization, this extra interest, which is being paid out, could be saved.

The volume of borrowings having increased, the tendency for slightly increased rates, in the first instance in the provinces, has manifested itself. This must go on, as the volume of borrowing is added to, as indeed it must be in fulfilment of the demand for capital for many objects, which have been sponsored and proclaimed by the Provincial Governments. Much care would be required in order to see that the total volume called for at any time is not in excess of the total volume available. Further care would be required to see that important objects in some places are not hung up, whereas relatively less important objects secure the money which is available. The care is required also to prevent the rates, at which borrowing takes place, from rising unduly.

The following table will show how the borrowing rates for the Government of India went up to as much as 7½ per cent on Treasury Bills and to 6 per cent on long-period bonds, because of the lack of care and because the pressure for Government loans was very much greater than what the market could supply:

July, 1922	6% free of income-tax issued at par.
July, 1924	5% 1933 Bonds, free of tax, issued at 94/4/0, giving a yield of 5.247% and 5% 1945/55, free of tax, issued at 99/-; yield of 5.079%.

July, 1925	No new loan, but there only a conversion loan on varying terms for loans maturing at different dates.
May/June, 1926	4% Loan 1960/70—tax bearing—issue price 88%. Yield 4¾%.
July, 1927	4% tax bearing; issue price 94/8; repayable 1st August, 1937—giving a yield of nearly 5%.
August, 1928	Two rupee loans giving a yield of 4.87% and 4.99%.
June, 1929	Two loans. Yield of 5.459% and 5.395% respectively.
July, 1930	6% tax-bearing.
December, 1931	6½% tax-bearing.
June, 1932	5½% tax-bearing.
August, 1932	5% tax-bearing.
January, 1933	4% tax-bearing.
February, 1933	4% conversion.

Treasury Bills Discount Rate

April, 1922	Rs. 4/14/- per cent.
April, 1924	Treasury Bills not sold during the year.
April, 1925	—do—
April, 1926	—do—
April, 1926	—do—
August, 1927	Rs. 4/1/6 per cent.
March, 1928	Rs. 4/9/6 do.
March, 1930	Rs. 6/0/0 do.
March, 1931	6.42% yield.
September, 1931	7.38% do.
September 1932	6.00% do.
September, 1933	2.6% (maximum yield during the year).

The competition offered by trade and industry is of great importance. The relative safety offered by Government borrowing may be higher. But the yield of debentures of a first-class industrial enterprise gives a security, which has only a notional inferiority, but which, for practical purposes, is extremely good. Where industry is, therefore, prosperous and is able to offer adequate security and to borrow at high rates, the state would either have to curtail its demand, or to pay higher rates itself. An excessive emphasis on state borrowing for all and sundry purposes must be avoided, because of the harmful effect on the enterprise of the community through

the depletion of capital and its diversion into relatively unproductive channels.

The idea, that capital in the hands of the state can do more useful work than capital in the hands of the private individual, must be abandoned, and it is necessary to emphasize this in view of large and unlimited programmes of socialisation and nationalisation, which are in the air. Whatever is taken out at one end, must necessarily have effect at the other end, and a very deleterious effect at that. Those, who entertain the belief that private enterprise will still go on with the same efficiency and produce the same amount of commodities and utilities, as it is producing now—no matter what the state might do and how much capital the state might carry away from the market—must be prepared for a rather rude shock and disillusionment. The market for capital is extremely sensitive and registers its reaction to every event in the world and to the announcement of every change or intention on the part of Government authorities. Great harm could be done to enterprises generally by an unwise and untimely statement of Government policy. We have the illustration in the speech of the Finance Member, Mr. Latthe, when he assumed office. With perfectly good intentions, he referred to enterprises for the generation of electricity and for its distribution to consumers, as sources from which he would draw money. While he was not ready with any programme at the moment when he spoke, and while his subsequent programme for taking money from these directions was extremely moderate, the effect of his statement was disastrous. Not only did it prevent further money going into these enterprises, but it depreciated to the extent of several crores the holdings of the people in these enterprises. Responsible persons handling the subject of Government borrowing must, therefore, put a very strong check on the words which they use. Any announcement of large and expensive programmes, involving large Government borrowing, would, even if such programmes had never materialised, have a very disturbing effect on the capital market.

NOTE ON INVESTMENT TRUSTS

By

MANU SUBEDAR

I

An investment trust company is a company, which has put forward as its object the investment of the company's capital and/or borrowings in a specific form, so as to create a trust between the company and the shareholder by the undertaking of the assurance given or conveyed in this manner.

The advantage of an investment trust is obvious. When an individual goes to the market to find an investment for his moneys in the form of securities of his own Government or of local and statutory bodies, or of foreign Governments, or of shares of companies operating in his own country or abroad, he does not go even with the necessary detailed knowledge to be able to select the investments, which would give him a safe return. For one thing, the resources of an individual are not large enough to spread out the investment, so as to secure against the rise or fall in the market. This rhythm of the market is seasonal in many countries and there is also a rhythm extending over a period of years, which may be eight, nine, ten, or fourteen years, differing at different times and in different countries in the world. In this rhythm it is found that, when securities with a fixed yield are going down in value, the equities are going up in value, and 'vice versa'. This phenomenon is well known and many attempts have been made to explain it on psychological and other grounds. The vicissitudes of the market are understood by some individuals, but not by all investors. Even when they are understood by an individual, he is not always able to guard himself against the risk of capital fluctuation, because of his limited resources. It is, therefore, through an investment trust that close knowledge of market conditions is secured and that, by a sufficient spread of securities in many directions, the investor safeguards himself to some extent against changes in their characters. It is not merely in point of time and yield that the securities are varied, but also with reference to industries. Certain industries develop a crisis and, if all one's resources were put in those industries, the crisis would engulf those resources. But an acute depression does not occur simultaneously in all industries, nor again in all countries, and when such a depression does occur, the excess available funds for investment necessarily *flow towards more secured investments, viz. Government*

loans, which therefore appreciate. It is through the instrument of the 'investment trust' that a small investor can, to some extent, guard himself against his capital being seriously depleted through these fluctuations.

In some cases the investment trust declares what investments it will confine itself to. In other cases the powers are given to the directors. The development of investment trust has been more serious in America than in England, and more serious in England than in India. Investment trusts as an intermediary body between the primary investor and the market can play a very important role not merely with reference to the primary investor, but with reference to the market. The instrument of machinery is also capable of being abused in the hands of unscrupulous men, who could use the financial powers of trust companies for rigging the market in their own favour, for depreciating certain shares and for appreciating them as and when it suits their private ends. The abuse is clearly an abuse of trust funds by trustees and the law must necessarily provide for a check against such abuses.

Once the investor buys shares in an investment trust company, he is tied to it. It may be that these shares are not freely marketable. It may be that it is not open to him to sell these shares outside, but they must be offered, when he wants to sell, to the other members of the company. Sometimes these other members of the company operate collectively through the company to buy out units, which come on the market and, either extinguish them, or put them forth again in a perpetual movement of new capital coming in and old capital going out. This also has given a variety of forms to the mechanism of the investment trust company.

The greatest deterrent to the growth of investment trusts has been the liability of shareholders of these companies to super-tax a second time, i.e. even if the super-tax has been already paid by the company itself. The liability to income-tax was also there.

II

1. Pending the institution of a National Central Organisation to absorb savings and direct investments of all such savings in the enterprise under the Plan, it would be desirable to institute a Special Investment Trust for the whole country, with branches or affiliations in each Province or component unit, to absorb every saving of the people and to invest them in enterprise conducted by, or under the authority of the National Planning Authority.

2. The constitution, powers and functions of this body, together with the principles of the absorption when the time

is ripe for the purpose in a Central Investment Board for the country, should be laid down as part of the general Plan. The terms and conditions under which such investment should be made by this statutory authority must also be prescribed in general by the instrument establishing such a Trust.

3. The management of the investments, their realisation, and change from time to time at the instance of the holder or for other reasons, must be regulated by the Bye-laws of the body itself made under the general authority given in that behalf.

4. Every facility should be given to the popularity and expansion of the operations of such a Trust, e.g. in the form of eliminating the liability of the individual investor for super-tax, so as to enable the Trust to make its operations as nation-wide as possible.

5. The Trust should be closely inter-connected and work in close co-operation with the Central Monetary Institution, whatever that may be, of the country.

Agricultural Credit

1. The principal handicap to the full utilisation of credit by agriculturists lies in the heavy existing load of indebtedness.

Relief of indebtedness may be achieved by the State taking over all debts and repaying the creditors on terms specifically settled in accordance with the general law passed in that behalf.

2. Methods of Debt conciliation, fixing of interest to a maximum rate as well as to the maximum aggregate payable on any loan are likely to be only palliatives, without remedying the evil radically.

3. Any system of debt relief to agriculturists must be conducted by the Local Banks, working in close co-operation with the Central Monetary Organisation of the country.

4. Borrowing by Governments in India should be restricted, as far as possible, to the Indian Money Market. It is desirable to conduct borrowing of every kind of Governmental authority by the Central Monetary and Credit Institution of the country.

5. Except for the Central Government of the country, no borrowing by any public authority should be allowed,—whether a Provincial Government, Municipality, a District

Board, or any other Statutory Corporation except for productive purposes, these purposes being defined carefully and definitely in advance, as involving some advantage within a prescribed period to the total national wealth of the country.

6. Even for the National Government of the country, borrowing should be restricted only to productive purposes, except in case of such an emergency like an earthquake, a famine or a flood, or for purposes of defending the country. In all other cases of borrowing by the Central National Government, productivity of the enterprise or service, proposed to be financed by such borrowed money, should be the first consideration and should be capable of verification within a prescribed number of years, say Five or at most Ten, so that, within that period, the full load of interest and a 'pro rata' amount for repayment of capital would be forthcoming from the surplus of the proceeds of such enterprise or service.

7. Short term borrowing by the Central National Government may be permitted under definite conditions and restrictions, so as not to unduly starve the Money Market of the country, for purposes of investment in industry or commerce.

8. Modes of short term borrowing by Government, as exemplified by the Treasury Bills, may be convenient for such institutions, as Banks or other bodies wishing to employ any part of their current funds so as to prevent these funds remaining idle. To Government, it would also be an advantage for meeting current needs, when the reserves have not been released in the same proportion as the needs arise.

9. Any borrowing in the shape of Post Office Savings Bank Deposit or Cash Certificates should be minimised, as much as possible. All Government borrowings hitherto should be consolidated in a Central Funds Account for facility of management and convenience of investment.

10. Earliest opportunity should be taken to repay outstanding indebtedness owing to creditors abroad and replace by corresponding investment of indigenous funds.

11. Funds of Life Insurance Companies and other similar institutions should be centralised and co-ordinated, so as to provide a larger nucleus for investment, mainly in enterprise under the National Planning Authority.

12. Bank Rate in India must be kept as low as possible. Fluctuations in Bank Rate should not be very considerable, Operations of the Central Monetary Authority in the country

in the ordinary Money Market must be so conducted as to minimise fluctuations in the Bank Rate and keep it as low as possible.

13. Scope for borrowing in the era of Planned Economy will be very considerably increased and care will have to be taken so to organise borrowing as to assure due and regular repayment of both capital and interest.

14. Undertaking of large scale public works out of borrowed capitals, as a means of solving unemployment amongst other things, should be kept as an objective in view by Government, and should be carried on wherever and whenever the facility for the purpose is available.

DRAFT MEMORANDUM ON LAND MORTGAGE BANKS

By

PROF. C. N. VAKIL

Land Mortgage Banks

The following note is based on the working of the Land Mortgage Banks in Bombay Presidency. The progress of these Banks in Madras is greater. Though details about other Provinces could not be obtained at short notice, the general experience may be taken to be the same throughout the country, and the consideration of the main problem will not therefore be affected.

Early History

Government first approved of a scheme for establishment of Land Mortgage Banks in 1927. By 1929, three primary land mortgage banks, one in each of the three linguistic divisions of the Presidency, were registered.

1. The main features of the scheme were:—

(1) The Banks were financed by the Bombay Provincial Co-operative Bank through their Land Mortgage Branch Department.

(2) Government purchased debentures issued by the Bombay Provincial Co-operative Bank worth Rs. 2 lakhs at 88% carrying 4% interest.

(3) The services of a Land Valuation Officer was provided for one year, free of cost to each Bank.

2. In the case of two Banks the area of operations extended to the whole of the District, while in one Bank it was restricted to a Taluka only. Every loan was finally sanctioned by the Bombay Provincial Co-operative Bank and the Registrar. The limit of individual finance was fixed at Rs. 10,000/-. Membership was restricted to borrowers only, but intending borrowers could join.

3. The bulk of the loans advanced was for redemption of old debts and in a few cases only, for installation of costly machinery and for improvement of land. A margin of two per cent was kept between the borrowing and lending rates by the Provincial Bank and the Primary Banks which worked

as agents of the Provincial Bank were given grants by the former to meet expenses.

4. The Board of Directors consisted of not less than seven members of whom one was the nominee of the Registrar, one of the Bombay Provincial Co-operative Bank and one elected by the Debenture holders residing in the area of operations of the Bank.

5. In 1935 after a review of the existing position by the Land Mortgage Committee appointed by Government it was decided to start ten new primary land mortgage banks which were registered in June, 1935. It was decided that the Provincial Co-operative Bank should not undertake the business of financing the Land Mortgage Banks for the following reasons:—

(i) The Bombay Provincial Co-operative Bank works mainly on short term deposits and utilisation of part of its funds for long term investments is likely to react on its credit.

(ii) Long term credit is a special type of business and requires distinctive handling and expert staff. An apex Bank called "the Bombay Provincial Co-operative Land Mortgage Bank" was, therefore, registered in December, 1935 to finance Primary Land Mortgage Banks.

6. The old Banks were advised to adopt revised bye-laws suggested for the new Banks and to apply for fresh loans to the Provincial Co-operative Land Mortgage Bank. The question of transfer of assets and liabilities of the Land Mortgage Branch of the Bombay Provincial Co-operative Bank to the Bombay Provincial Co-operative Land Mortgage Bank is under consideration.

Primary Land Mortgage Banks

7. The salient features of the new scheme are given below:—

(a) The area of operations of a Primary Bank is restricted to a revenue district. Only in two districts where special conditions for development exist, the area of operation is less than a district.

(b) Both borrowers and non-borrowers are allowed to be members. Provision for admission of non-borrowing members has been made with a view to enable the Banks to enlist the services of influential and public spirited men for efficient management of the Banks. Co-partners and persons

interested in the property of the borrowing members are also admitted as 'B' class members, without any right to vote.

(c) Funds are raised (i) by issue of shares, (ii) entrance fees and other fees and charges, (iii) loans from Provincial Land Mortgage Banks.

(d) With a view to secure careful and business-like management, certain safeguards have been adopted. The bye-laws provide for the nomination of Directors by the Registrar for the first three years. The bye-laws also, provide for the sanction of the Registrar for all loans from the Provincial to Primary Banks and from Primary Banks to individuals in the initial stages.

(e) Primary Banks employ Land Valuation Officers, who are lent hands from the Department. In order to meet a part of the cost of these officers, Governments give a cash subsidy of Rs. 5,000/- per annum, for the first three years to be distributed equally between the ten new Banks.

(f) **Procedure for sanction of loan applications.**

On receipt of an application by a primary bank, the Manager first decides the 'prima facie' eligibility of the application. The Land Valuation Officer, then inspects the lands and submits his report regarding their evaluation in respect of market value, yielding capacity and rental value, legal title, and extent and nature of each person's interest in them. The papers are forwarded to the legal adviser, who certifies as regards the marketable title of the applicant to the lands proposed to be mortgaged to the Banks. After obtaining the sanction of the Board, it is forwarded to the Provincial Land Mortgage Bank through the Assistant Registrar for Land Mortgage Banks, who is an officer of the Department. When the Provincial Land Mortgage Bank sanctions the loan it communicates the loan sanction through the Assistant Registrar for Land Mortgage Banks to the Primary Land Mortgage Bank. In case of loans for redemption of old debts conciliation is tried through a board constituted for the purpose for each taluka. On completion of all requirements the loan is disbursed by the Primary Bank by obtaining funds from the Provincial Bank.

(i) Besides redemption of old debts, loans are also granted for (1) Improvement of lands, (2) Purchase of costly agricultural plant, (3) Purchase of land for more economic cultivation of the existing land.

(ii) The maximum and minimum limits for loans have been fixed at Rs. 10,000/- and Rs. 400/- respectively. With the special sanction of the Rgeistrar, the maxi-

mum limit is allowed to be exceeded. Immovable property of the value of at least twice the loan granted is taken as mortgage by the Bank with or without possession.

(iii) The mortgaged property will be revalued once in three years so that if there is any diminution in the security the borrower can be asked to make good, the deficit of the loan may be recovered at once.

(iv) The borrower is at liberty to repay the loans either in equal annual instalments of principal, interest being calculated on the amount outstanding, or by equated annual instalments including principal and interest, which in either case are not to be spread over a period exceeding 20 years.

(v) The rate of interest on loans is not to exceed 1½% over the rate charged by the Provincial Land Mortgage Bank. The present rate charged to borrowers is 6%. This is liable to change according to changes in the money market.

A Note on the Working of the Provincial Co-operative Land Mortgage Bank

8. In pursuance of the recommendations of the Land Mortgage Banks Committee appointed by Government, the Provincial Land Mortgage Bank was registered in December, 1935. Its object is primarily to finance Land Mortgage Banks. Membership is open both to individuals and Primary Land Mortgage Banks. The capital of the Bank is Rs. 10 lakhs made up of 10,000 shares of Rs. 100/- each. The administration of the affairs of the Bank rests in a Board consisting of 15 members. The Registrar, Co-operative Societies, who is the trustee for the Bank is an ex-officio member of the Board. Of the remaining 14 members 5 are representatives of individual members and 2 are nominated by the Registrar with the previous approval of Government. One is nominated by the Provincial Co-operative Bank and one is the Managing Director of the Provincial Land Mortgage Bank. The Board may delegate all or any of its powers to the executive committee consisting of 6 members. The Provincial Land Mortgage Bank raises funds mainly by the floatation of debentures up to 25 times its paid-up share capital and reserve fund. Under the bye-laws of the Provincial Co-operative Land Mortgage Bank, the Board of the Bank may with the permission of the Registrar as trustee issue debentures of one or more denominations for such periods as it may deem expedient on the security of

mortgages and other assets transferred by Primary Land Mortgage Banks to the Provincial Land Mortgage Bank and of other properties of the Bank. The total amount due on the debentures shall not exceed the total amount due on the mortgages, the amounts paid thereunder and remaining in the hands of the Board or of the trustee. Government has guaranteed fully and unconditionally the principal of and the interest on the debentures of Rs. 20 lakhs so far. The mutual obligations and rights of the Government, the trustee and the debenture holders have been embodied in a document called the Debenture Trust Deed which is executed by the Provincial Land Mortgage Bank.

9. The first issue of debentures amounting to 20 lakhs was floated last year at 3¼% per annum. The debentures worth about 16 lakhs out of 20 lakhs were purchased by the Public and the remaining were purchased by Government. The debentures are irredeemable for a period of 20 years. The Bank is required to maintain Sinking Fund Account in which annual payments are to be made in order that the debentures could be redeemed at the date of maturity from the collections put into Sinking Fund.

10. Government have given every possible support to make the debentures of the Bank attractive to the investing public. Indian Trusts Act have been amended suitably so as to include the debentures as trustee securities. The duty chargeable under the Indian Stamp Act on the deeds of transfer in respect of the debentures of the Bank has been remitted.

11. One fourth of the net profits of the Provincial Land Mortgage Bank, every year shall be carried to the Reserve Fund. The balance is available for distribution of dividend not exceeding 6 per cent per annum.

Concessions Given by Government

12. In addition to the concessions given to the Primary and Provincial Land Mortgage Banks stated here-to-fore, Government have also given the following facilities:—

(a) Officers of the Land Mortgage Banks are allowed to have a search into the registration records free of charge.

(b) Village records are also open for inspection by an officer of a land mortgage bank.

(c) One Mamlatdar in each District where a Land Mortgage Bank is working is allowed to work with the Board of Conciliation set up by a Primary Bank so that with his influ-

ence, obdurate creditors are brought round and the work of the Board is facilitated.

(d) Government have also agreed to forego the leave and pension contributions of the Land Valuation Officers who are lent hands of the Department.

(e) Government have given a free grant of Rs. 500/- to each of the ten Primary Land Mortgage Banks registered in 1935 and a free grant of Rs. 10,000/- to the Provincial Land Mortgage Bank in the first year and further grants to make good the deficits in the next two years.

13. The technique of Land Mortgage Banking is difficult and complicated. The object of the Land Mortgage Bank is to provide long term credit on easy terms to agriculturists on security of agricultural land. For providing this credit an elaborate machinery has been considered to be necessary. In order to be eligible for this credit, the borrower has to fulfil 3 essential conditions:—

1. He must be able to offer as security for the loan, lands worth at least twice the amount of the loan.
2. The title to the lands should be clear and marketable.
3. There must be adequate repaying capacity i.e. to say sufficient margin of profit after meeting all the current expenses both domestic and agricultural.

The responsibility for making the scrutiny of loan applications, with a view to ascertain whether the conditions are fulfilled is laid upon the Primary Banks. The scrutiny of loan applications calls for high standard of judgment and experience and insight on the part of persons who are to estimate the value of lands and repaying capacity, etc. Though in theory the Directors of the Bank who are elected by the shareholders are supposed to bring their knowledge of local conditions to bear upon the examination of the loan applications, in actual practice it is found that they depend upon the recommendations of the paid staff of the Bank. So, much depends upon the calibre and efficiency of the Land Valuation Officer employed by the Bank. The number of applications rejected on the ground that one or more of the conditions are not fulfilled by the applicants, is very large, forming nearly 60 to 70 per cent of the applications. The procedure prescribed for disposal of loan applications is rather dilatory, partly due to the fact that the borrowers themselves are not able to supply all the information about their debts, income, lands, etc. promptly and correctly, and partly due to the fact that inquiries are

required to be made in a number of details. Investigation into the title of the applicant for land is one of the major causes of delay, for, law regarding property is very complicated. If it were possible to devise some method by which the title for land could be verified easily, the work of the Banks will be facilitated and speeded up.

14. It is incumbent upon the Banks to conciliate the debts proposed to be redeemed by a loan from the Bank by negotiations with the creditors, as the Banks have no power to compel the creditors to disclose the true state of accounts or to reduce the debts. The conciliation at present is on a voluntary basis, and not very effective.

15. One of the problems in connection with the Land Mortgage Banks, is how to provide for the shorter requirements of the borrowers, whose credit in the market is practically nil as their property is mortgaged to the Land Mortgage Banks. No satisfactory solution has been found in this respect.

16. It is necessary for the borrowers who have taken loans from the Land Mortgage Banks to pay off the dues of Sowkars to practice thrift in order that they would be in a position to repay the instalments of the loan regularly. They should take care to see that they do not get into debt again. The success of the Land Mortgage Banks depends on the extent to which the borrowers have improved their economic conditions by their industry and thrift after *their free lead* from the debts.

The following issues arise from the above survey:—

(1) In what way can the resources of the Land Mortgage Bank be increased?

(2) Is it possible to reduce the rate of interest at which the Bank lends?

(3) In what way can the current needs of a farmer who has mortgaged his lands to the Bank be met?

(4) Is it possible to simplify the procedure by which loans are granted?

(5) To what extent should Government assistance and control be increased or decreased?

(6) Are any changes necessary in the administration of the Bank?

NOTE ON POSTAL BANKING

By

PROF. K. T. SHAH

The Post Office in India conducts a Banking Department, almost entirely devoted to the Savings Bank Business only. The volume of the business available for this Bank is indicated in the following statistics:—

A. Post Office Savings Bank.

(In Lakhs of Rupees)

Year.		Deposits.	Withdrawals.	Amount outstanding.
1930-31	..	**24,36**	**25,50**	**37,02**
1934-35	..	**38,67**	**37,26**	**58,30**
1939-40	..	**40,51**	**45,22**	**78,32**
1940-41	..	**25,35**	**45,09**	**59,51**
1941-42	..	**21,91**	**30,18**	**52,07**
1942-43	..	**22,26**	**22,84**	**52,22**
1943-44	..	**35,22**	**24,19**	**64,18**
1944-45	..	**43,76**	**28,94**	**80,22**
1945-46	..	**74,42**	**41,30**	**1,15,04**
1946-47	..	**91,68**	**64,37**	**1,42,35**
1947-48 (Preliminary 1st April to 14th August.)	..	**37,45**	**33,66**	**1,46,14**

Source: Report on Currency & Finance 1947-48, p.153.

(In Lakhs of Rupees.)

B.*The Total of Amount outstanding in the Post Office

			Cash Certificates was	37,75
"	"	"	**Defence Savings** was	5,18
"	"	"	**National Savings** was	74,95
"	"	"	**Defence Savings Bank** was	6,03

*(For the year 1947-48 preliminary 1st April to 14th August.)

Source: Report on Currency and Finance, 1947-48, p. 152-153.

The conditions for which the accounts of the Post Office Savings Bank can be maintained and the restrictions of the volumes to be held therein, as well as for purposes of operation, are so considerable that the utility of this system is very considerably limited. The handicap also on the small trader, having occasion to remit from place to place through the agency of the post office is disproportionate to all reasons of cost or service. And it becomes particularly undesirable when one finds in contrast that remittances within the country of large sums are carried out at relatively very little cost. It seems to be an axiom of sound banking arrangements within a country that all charges for internal remittance should be abolished. In India also, it is not impossible to attain this objective, though even in regard to large remittances for commercial purposes, the retention of a charge is not unknown.

If the Postal Banks work in concert with the Reserve or the Imperial Bank of India, and were to be reorganised in such a manner that no actual transfer of specie or currency need take place but amounts may be credited or debited in the different postal centres from where and to which such remittances are made, the utility of the Postal Bank would be very largely increased and its popularity enhanced in proportion. A new negotiable instrument, or a new form of non-legal tender currency, may be invented to serve as the Postal Cheque,—something like the present day Postal Order, though issuable and available at very little, if any cost, to those using it. This would add to the utility of the Bank and its instruments considerably. For this purpose, it would, of course, be necessary that every adult citizen, who has some occasion to make or receive payments in wages, interest or any other form should be required by law to have an account of his or her in a Bank. The postal bank would, of course, be the most common facility as being spread out in the widest possible net-work of branches throughout the country and as such most readily accessible to the poorest man. As already remarked, if the Postal Bank is to discharge all the activities that may reasonably be expected of it, it will have to work in concert with the Reserve or the Imperial Bank of India and engage in all legitimate banking business and not exclusively savings, so that every possible banking facility may come to the door of the commonest individual in the country.

NOTE ON MOBILISATION OF CAPITAL

By

MANU SUBEDAR

The heading selected by the Committee appears to be loose and misleading. This military word means calling up forces in anticipation of their immediate use. This, in its application to the capital of a country, does not make much meaning, because the capital in the form of capital-assets is in the hands of millions of people all over. It means assets, that have a value, which are not intended for immediate use. It involves the savings of the community as a whole in the form of machinery of production and land, mines and forests, in factories, in transport equipment, &c. Over and above all this, there is a fringe of free capital, i.e. capital, which is not yet converted in any permanent form, but which could be converted in whatever form is considered most desirable or attractive. This free capital would be also largely loanable capital.

When there is a war or any other national emergency, various measures are taken, by which the amount of free capital in the hands of the public could be used for the national emergency. Steps are taken, by which it is made difficult to use it for those objects, which may be dear to private individuals, but which would create a diversion of what is needed for the country as a whole.

In peace time and in normal times there may be regulation, but there cannot be, and should not be, heavy restrictions. The regulation with regard to the use of capital would, in the case of India, be regulation in order to prevent duplication and waste in those activities and those industries, which are already well covered and well financed. The regulation is not always against the interest of the owner of the capital, though it is often irksome to individuals, who dislike interference from the state. It may be, for example, decided that, no activity, which would involve capital expenditure, should be undertaken without a licence, and such licence should not be given where, in the opinion of the state, there is already sufficient capital invested. Over-competition is as much an evil as a monopoly, and it is wrong to say that the public reap the benefit of excessive competition, because the uneven and unsteady activity in any industry does not tend to reduce the

cost to the consumer in the long run. On the other hand, it may be the desire of the State to see established in India numerous industries of national importance, particularly from the point of view of defence. No state could afford, in modern times, to go along without industry for the production of transport equipment both by land, water and air, and, so long as the use of force remains in the world even for defensive purposes, no state can do without the armaments industry.

The evil of the armaments industry being owned by private individuals, who stimulate martial ideas and indulge in war-mongering, has been seen in many countries, where, by regulation, armament production is confined either to the state or to strictly licensed companies, and there is adequate production only for home. When the state desires thus to see some activities started early for national purposes, the method is to shut out this scope for other activities by restricting the issue of licences.

To what extent it is possible or desirable to control capital in private hands used for such individual purposes as marriage and death ceremonies, indulgence by extravagant buildings or equipment for personal use, foreign travel with no other object than personal enjoyment, and expensive feasts, dinners and entertainments, appears at the present stage to be a little beyond the scope of our enquiry. But these purposes could be mentioned. They cut not a small hole in the available free capital of the community. Various countries in various ways have been obliged upon occasions, to put checks even in normal times, and many more countries have done so in times of emergency. There are, further, activities connected with popular enjoyments, such as circuses, carnivals, horse races, dog racing, theatres, cinema, and fetes. There are outlays on exhibitions, some of which are run commercially. It is possible that some of these things constitute bona fide trade in the hands of many people. On the other hand, from the point of view of the country as a whole, even if some of these activities bring money to the pockets of some individuals, they may be, on some occasions at all events, and, if carried on in an unregulated manner, at all times, a danger. The regulation may take the form of restriction of quantity as well as of a tax both for this class and the class mentioned at the beginning of this paragraph.

If by mobilisation is implied, how and in what manner the state can get hold of the free capital in the hands of the community, we would say that such an attempt ought not to be made until the purposes, for which the state wants the

money, have been carefully examined. It is not always that capital in the hands of the state is more usefully spent than capital in the hands of the private individual. On the contrary, in some cases, it is private greed, which leads to the finding and the establishment of new enterprise. To the extent to which, however, the state has defined its objects and is satisfied by all possible tests, that the objects are such as should take priority over all prior activities, to that extent the method for securing an adequate amount would be as follows.

All individuals seek safety for the funds which they have saved. Many of them have funds in amounts, which are too small for any independent activity. These mass savings collectively run into crores of rupees. If there were easy means of putting savings into a safe custody in the hands of the state and if the machinery was not cumbersome, easy to understand and incapable of being misused, much money could be secured from the working classes. The savings bank in India is already established on a sound footing, but in many directions its activities could be expanded so as to make the savings bank the poor man's bank. It is receiving deposits. Very rightly, it is not lending out, but we think the possibility of its undertaking remission work should be explored. In the first instance it should be possible for the savings bank to remit money free of cost from the account of an individual "A" in one place to the account of the same individual in another place. Later it should be possible to attempt the next step, viz. to remit from an individual "A" in one place to an individual "B" in the same place. The third stage would be, when the remission of money would be made possible free of cost from an individual "A" in on place to an individual "B" in another place. These facilities are bound to increase the amount of money remaining in the hands of the state at any time on the savings bank account. They are bound to increase the deposits.

The postal cash certificate represents a system of saving convenient to the state as well as the party, who has the spare cash. It is in the nature of a fixed deposit for the period indicated, generally five years. It has been found necessary and useful to allow means for cashing earlier, if some unforeseen event occurs and in such a case there is the penalty of reduced interest being given. A considerable amount of capital falls in the hands of the state by this machinery and, if other facilities than those, which are at present supplied, are asked for by the public, the state should have always elastic arrangements. But rigid precautions must be taken

against the possibility of fraud either on the state or on the individual holding the certificate.

Voluntary saving by the working classes is difficult at all times. But the instrument of the Provident Fund provides for the working and the middle classes a solatium to the deduction at the source before the wages and salaries are paid out. Such Provident Funds, with reference to the services under them in the hands of the Government, run into a considerable amount and provide useful means for the absorption of Government loans. Very rightly, there are restrictions as to the nature of the investments, in which such Funds could be held when they are in the hands of private individuals, and it is good that, in law, Provident Fund is given preference, when a concern liquidates, or when a party becomes insolvent, over all other claims. The principle underlying is that of a compulsory saving and it is a principle, the extension of which can be certainly considered. In effect, the state absorbs the possible savings in the hands of the working population, not as taxes for its use, but as funds on loan. But, where there is a constant and recurring flow, a certain nucleus always remains with the state.

Insurance premium is another form of the savings of the people, largely of the middle and rich class. Encouragement is given to this by exemption from income-tax. When this encouragement was abused by the rich through a single premium policy and other devices, a limit has been put under the Act of 1939.* This has been done in blind imitation of conditions in the United Kingdom, which are very different. Cash savings, or savings in the form of ornaments, or little agricultural properties, are unknown in the United Kingdom to the working classes. They are the usual rule in India both

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* **Section 15(1)** "The tax shall not be payable in respect of any sum paid by an assessee to effect an insurance on the life of the assessee or on the life of a wife or husband of the assessee or in respect of a contract for a deferred annuity on the life of the assessee or on the life of a wife or husband of the assessee or as a contribution to any Provident Fund to which the Provident Fund Act, 1925, applies.

(2) Where the assessee is a Hindu undivided family, there shall be exempted under sub-section (1) any sums paid to effect an insurance on the life of any male member of the family or of the wife of any such member.

(3) The aggregate of any sums exempted under this section shall not, together with any sums exempted under the second proviso to sub-section (1) of section 7 and any sums exempted under sub-section (1) of section 58F, exceed in the case of an individual, one-sixth of the total income of the assessee, or six-thousand rupees, whichever is less, and in the case of Hindu undivided family, one-sixth of the total income of the assessee, or twelve thousand rupees, whichever is less."

for the working classes and for the middle classes. Land and property have a peculiar attraction. The savings of people going in this last-mentioned class are lost to the state, while those going in insurance premia are secured to some extent only. Upto 1938, there was no law compelling the investment of premia in Government Paper. Nor was there any schemes of deposits for life insurance companies, which were working in India. Even now the arrangements cannot be considered to be adequate.

The greatest harm, so far as the field of insurance is concerned, is through the working of foreign companies in India. They take away the lion's share of the insurance business as a whole, though Indian companies are now taking an increasing share of life business. Preference to Indian companies at present is entirely on the voluntary basis, as there could be no administrative or legislative action on the part of Provincial or Central Government in the Government of India Act (section 113), by which a discrimination could be made against companies registered elsewhere in the British Empire. The present state of affairs must be considered as chaotic and most objectionable. Insurance, so far as fire, marine, accident, motor car and other risks are concerned, has become a necessity of modern life. Institutions supplying this form of service have grown in India, and yet the bulk of the Indian business goes to foreign companies. This arises principally from the greed of middlemen agents, influential Indians uttering patriotic words outside, getting the agencies of foreign companies tempted by the extra gain to themselves, and becoming channels through which much Indian wealth is drained abroad. The profession of insurance agents must be, therefore, licensed, and the licence should be divided into three classes so as to penalise those, who confine their business to the securing of work for foreign companies in India. Apart from this, there can be many other ways, in which the flow of business to Indian concerns could be expedited. The suggestion, that this proposal is of an expropriETORY nature, is wrong. It is the duty of the state to safeguard the interests of its subjects. Many Indians have been known to have lost heavily in the matter of insurance in foreign companies from Austria, Germany, Japan and other places. At one time there was very little obligation even with regard to placing information before the Indian public before a foreign concern was able to canvass insurance in India. While the information is now compulsorily to be filed with the Company Registrar, it is inadequate and in any case there never is any control. It is the prestige of the local agent, which secures the business. The local

agent earns his commission, but the bulk of the profits are remitted abroad. Even taxes paid by foreign concerns to the state are inadequate, in spite of the recent tightening of the machinery.

With regard to life insurance, we would advocate the concentration in the hands of the state of the life insurance business in the country. This is known crudely as nationalisation. The grounds for this suggestion are again, to safeguard the public against mushroom companies, which grow up, advertise, mislead and cheat. In other cases difficulties are made at the time of the payment of the claim, and arbitrary delays and deductions are not unknown. In most cases the cost is heavier than would be the case under a State Scheme. Life insurance business belongs to that class of routine enterprise, in which no enterprise is required. The premia to be paid are based on statistical returns. The penalties for interrupted instalments, or non-payment, are in many cases unduly heavy. The canvassing, agency, direction and other charges are unnecessarily high at present. The Post Office could, after the preliminaries are settled, collect the payments. This machinery, on which expenditure is already made, could be used for the purpose without serious additional outlay. The other ground, on which the scheme is recommended, is that frauds, through the inefficiency or dishonesty of doctors or agents, which constitute one of the bug-bears of the life insurance business, would be less frequent in the state scheme, as the state would have the machinery of the district administration and the police to effect the enquiries essential for checking up facts regarding a new policy. The suggestion, that corruption would be much bigger where the state is concerned, is gratuitous. It is not borne out by experience in other fields and it belongs to that order of diffidence, which must be depreciated, as it would prevent every scheme for the amelioration of the people.

The greatest merit of the scheme suggested is, however, that an enormous and growing amount of money at present flowing into private hands—partly in foreign hands—would fall into the hands of Government to be used beneficently for the people. The indications given here are only of a skeleton scheme and are necessarily sketchy. The details, however, could be worked up at any time when the general principle of the scheme was approved. We consider this as the biggest and the most smooth running project for drawing the necessary capital for beneficent purposes in the hands of the state. Indeed this would be one of the methods to stem the export of a country's savings to foreign countries and even, under

the 1935 Act, the creation of a state monopoly directed equally against private enterprise, which is Indian or British, or foreign, would be valid. A suitable arrangement would have to be made for existing business in the hands of private enterprise, and Indian companies, which would lose their work would have to be compensated and their staffs absorbed in the state work.

Another class, which has savings which are not fully used at present, are shroffs, Mahajans and traders in the interior, who have to deal on the cash basis. The increase of banking habit everywhere would reduce the need for free capital in the hands of private individuals. Once the money goes into banks, it will come to the state either directly or through the banks buying Treasury Bills.

The amount of idle money lying in the pockets of the people and in their homes is still enormous. This is due to the popular habits in India, which cannot be changed in one day, but it should be possible, by changing the habits of holding the money in the form of coins and notes, and by changing the habits of the people with regard to purchases made by them and with regard to payments made by them, to bring about a larger use of credit instruments, such as the cheque, than hitherto. This, again, would drive most of this money either in savings banks or in commercial banks, and from their hands into the hands of the state.

Comments are not made here with regard to the possibility and the extent of borrowings of the state, as the same has been dealt with in the chapter on Government borrowing. But it is clear that Government borrowing should be done intelligently. You can only mobilise an army, which exists there. You cannot make an army out of a rabble in one day, and very harsh regulation would defeat its own end. If the state took too much money from the public, it will starve trade and industry, which would, in their turn, not only impoverish the community, but dry up the sources of taxation. The state must, therefore, regulate its borrowing strictly to its needs and choose the time when to put forward its loan programmes in such chunks as the market can readily absorb. The state, further, has to provide loans for all classes of lenders—those who wish to lend for a month or two, and those who wish to lend for a long period, those who have got money in January, and those who have got money in the next month, those who are willing to take some risk for a higher per cent and those who are not willing to take any risk. It should be possible to have Government security in suitable form on tap. There is no charm in putting forward loans once

a year in large volume. It has only a disturbing effect on the market. The market jobbers and others like it, because it gives them an opportunity in the ups and downs to make some money from the public. The permanent investor would be happy if he could get Government loans at a given rate any time during the year.

The driving of certain funds, such as trust funds and the funds of insurance premia, into a narrow channel, of which Government loans constitute the principal item, has been the other method adopted everywhere. It has also been adopted in India, but its variations and niceties could be further studied. There is no reason why religious trusts and charities, caste funds and all other funds of a communal nature should not be compulsorily held in Government securities. The alternatives at present, viz. giving out in mortgage, or purchasing properties or keeping deposits with private individual firms or in banks, are not fields, which would be starved out, if this restriction was made.

The capital levy is the privilege of every state, but it is seldom used in peace time. It is used in an emergency when it is seen clearly that the state is not in a position to meet its current obligations from taxation, however heavy it might be. Capital levy, however, is a very complicated issue. Being an emergency tax, there is no material available in the hands of the Government to make clear as to what is to be taken. The different forms of capital have to be valued, which is a problem by itself of no small magnitude at any time. Capital levy, because it involves the payment of funds, which the owner of the capital asset has not immediately got, only drives most of the holders into the market either to borrow or to sell. The rates for loanable capital would, therefore, go up and the value of real property, lands, factories and equipment come down. This displacement in economic life does not in the long run benefit the state to the extent to which it appears to benefit on paper. The paper calculations are misled by a general movement, which has a deleterious effect with regard to future capital savings. There is a general desire to take capital out of the country. A certain amount of the capital does fly out of the country, and foreign residents and others are deterred from bringing more money inside. Unless the emergency is, therefore, one of life and death, the capital levy cannot be suggested as a means for the state to get hold of capital funds.

Capital levy in effect is only a variation of a compulsory loan programme. The compulsory loan programme has been used, often by secret persuasion, in many countries. Persons

in authority would call up men of status and resources and would put down, after some bargaining, the amount, which they have to take, of the new issue of Liberty Loan, or whatever it is called. The immediate effect is that, as soon as a person has subscribed, not having the money to pay, he goes to the market to sell it off. There is a discount—and sometimes a heavy discount. The person forced to pay the loan finds the money for the discount. In fact he has paid a tax, the money for which goes into the pocket of the state today, but which comes out of the pocket of the state when the loan is repaid.

Repudiation of all debts, or, partial writing down of loans, has occurred in many countries. It is the worst expedient, which could be adopted by a state. Conversion, on the other hand, is a legitimate remedy which has the effect of reducing the burden of interest charges; but it does not increase the volume of capital forthcoming to the state.

It will be seen thus that, when the state decides to get hold of free capital in the hands of the community, which is not unlimited at any time, great care has to be taken as to the manner, method and the volume of public borrowing put forward. If such care is not taken and if there is an excessive issue, there will be an immediate depreciation and the credit of Government would suffer. When the credit of Government suffers, the burden is borne by the tax-payer by increased interest charges, as there is more disinclination to support Government loans than before. An excessive issue of bonds, cash certificates, or any other variant thereof, has the same deteriorating effect on Government finances generally, as the excessive use of the printing press. It is open to every Government to issue more currency and to replenish its diminishing resources by a still larger issue. Such a device, whenever it has been used, either through the tyranny and greed of an individual, or through the dire need of a nation after a prolonged war, has invariably led to grave economic disorders, from which it takes the country many years to recover. Not only is this expedient, therefore, to be avoided, but everything, which is a refinement of the same expedient, must be carefully eschewed.

NOTE ON AGRICULTURAL CREDIT

By

MAURICE FRYDMAN

Conclusions:

1. In the present social system there is no hope for the agriculturist to get rid of his chronic indebtedness without a sweeping legislative and financial action for
   (a) debt conciliation,
   (b) limitation of the accumulated interest to 100% of the principal or to 5% simple interest, whichever is lower.
   (c) Issuing of State bonds bearing a nominal interest, say 1%, and making obligatory on the creditors to accept them in liquidation of debts. The bonds should be made redeemable at the rate of 2—2.5% every year. The bonds should be given all possible privileges of a government security and special steps should be taken to keep up their marketable value at par.

2. All short term credits should be given through Village Banks. The Village Banks should be financed by the villagers and the moneylenders on the basis of collective security of the entire village or group of villages. The Village Bank should also become the purchasing and marketing agency for the village.

3. Long term credits should be given by District and Provincial Land Mortgage Banks. They should be financed by the State **out of the State revenue**, and should not invite profit seeking capital, because:—

4. In the present state of land sub-division and low soil fertility all investment on land improvement and irrigation cannot pay even a comparatively low bank rate of interest.

5. It should be made obligatory on the Governmnt to set aside a certain proportion of the land revenue for financing agricultural improvements through interest free loans, repayable in easy instalments.

6. Irrigation and prevention of land erosion, and reafforestation come under land improvement and should be financed out of revenue only.

7. All imports of agricultural products should be heavily taxed and the revenue from this source ear-marked for the major land improvement schemes. The raise of agricultural prices should benefit the primary producer first through proper legislation concerning tenancy, rural marketing and control of grain trade.

RESOLUTIONS OF THE NATIONAL PLANNING COMMITTEE ON THE REPORT OF THE SUB-COMMITTEE FOR CURRENCY AND BANKING

The Interim Report of the Currency and Banking Sub-Committee was presented by Mr. Manu Subedar, Chairman of the Sub-Committee, on the 7th May, 1940. Prof. C. N. Vakil, Secretary of the Sub-Committee, was unable to be present. Discussion continued on the 9th and 10th May. The following resolutions were tentatively adopted:—

1. The Reserve Bank of India is dominated by British financial interests and carries out policies dictated by them. The Bank must, therefore, be nationalised and be owned and managed by the State.

2. Banking business of every description must be carried on under a license, and must be subject to such regulation, supervision and general control as the Central Banking authority imposes from time to time.

3. One of the essential conditions of the license to do banking business in this country should be that at least 95% of the personnel will be Indian. In the case of banks registered in India, all the directors should be Indian nationals, the employment of any foreigner in any such bank will be left open as expert adviser only, and not as chief executive or manager.

4. Banks not registered in India should be prohibited from receiving any deposit or raising loans, in the same manner as in the United States of America.

5. Banking facilities in the country must be widened and made easily available to the mass of the people, by means of an adequate number of branches of large Joint Stock Banks, small local banks, improvement and extension of Post Office Savings Banks, Co-operative Banking Societies, and private bankers, under a proper system of regulation.

6. All inland remittance charges should be eliminated. The Hundi system should be encouraged and strengthened, and Discount Houses should be established.

7. The Stock Exchange should be re-organised, and should work under very strict public control, so that they might function primarily as institutions to help investors.

8. All commodity markets, in which future or forward dealings take place, must be under regulations approved by the State.

9. All import and export trade must be done under a system of licenses, which should be freely given; but which are so designed as to enable the State to have the fullest information regarding the direction of the trade, and to facilitate control and regulation as they are found necessary.

10. Increasing use should be made for foreign trade in staple articles, of recognised corporations, especially charged with functions of exporting and importing.

11. The entire foreign exchange business of the country should be conducted under the complete control of the Reserve Bank, and in such manner as it may determine from time to time. The Reserve Bank should make Foreign Exchange available to the other banks within limits of safety for the external value of the Indian currency.

12. Drastic steps should be taken to prevent drain of funds from the Indian money market in respect of insurance premia. The State should exercise greater control over all insurance funds with a view to ensure not only their safety but maximum utilisation for national purposes.

The Sub-Committee had recommended the extension of the State Insurance Scheme to the public with a view to eliminate private enterprise in this field. As this question had also arisen in the consideration of the Insurance Sub-Committee's Report, it was decided that a decision should be taken at a later stage.

13. The value of the Indian Currency Unit, whether at home or abroad, should be regulated exclusively by considerations of benefit to the Indian national economy, and not in the ruinous manner as at present, when the Rupee is linked to the Sterling. The link of the Rupee with the Pound should be broken as early as possible, all necessary steps and precautions having been previously taken.*

14. While in Planned Economy, fluctuation and depressions will be reduced to a minimum, it is desirable that, mean-

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*There was a Note of Dissent to this Report by Prof. K. T. Shah, which was discussed for some time. Several Members stated that while they were attracted by this new approach to money, it was not clear to them how it could be made feasible and practicable. It would be in the nature of an experiment. Mr. Ambalal Sarabhai suggested that Prof. K. T. Shah might write a fuller note on the subject, explaining his ponit of view and how it could be applied. This note should be circulated to members of the N. P. C. Prof. Shah agreed to this.

while, these should be controlled, and sudden or prolonged fluctuations avoided, by the Central Monetary authority in the country. For this purpose several Index Numbers, based on different commodities and different considerations, should be kept to indicate the direction of these fluctuations as also the progress of the Plan. The Central Monetary authority should regulate the price levels and other conditions through the adjustment of the volume of currency and credit.

15. No reserves against the Indian Paper Currency, or the Indian Credit and Banking system, should be in sterling, as hitherto. All such reserves should be normally in India, but the Reserve Bank should have discretion and powers of holding a portion at such places abroad (in gold only in quantities laid down by law) as is considered desirable and necessary. Reserve in gold should not be permitted normally to be kept out of India.

16. The export of gold from India on private account must be prohibited forthwith, and the import of gold must be confined to the Reserve Bank only.

17. To improve the credit and financing facilities available to the primary producer, we recommend that warehousing facilities should be provided or organised by the State all over the country to enable the producer to place his produce in such warehouses. We recommend that the charges in connection with these warehouses should be eliminated and borne by general reserve, or, in any event, such charges should be as low as possible. Against the produce thus deposited, a receipt should be given to the producer who should be entitled to raise the money needed on the strength of this receipt.

18. The State will prevent profiteering and control price levels in the interests of the consuming public and of Planned Economy.

19. We recommend the establishment of Consumers' Associations at principal centres, with a view to protect the interests of the consumer in respect to quality, price and weight of goods, etc.

In order further to protect the buyer and check the habit of bargaining, we recommend that retail dealers should be made to fix their prices and exhibit them openly.

QUESTIONNAIRE ISSUED BY THE N. P. C.

1. What are the institutions concerned in the mobilisation, attraction and investment of local or foreign capital? To what extent do these institutions need to be varied, improved or expanded, so as to supply adequately the capital needs of Agriculture, Industry, Commerce and other essential services to secure the optimum development of the Provinces all round?

2. What measures, if any, have been adopted in your Province to control the supply and regulate the conditions of working of foreign capital invested in the industrial concerns operating in your Province?

3. To what extent is the reservation, provided for in the Constitution of 1935, of all powers and functions in regard to the control and regulation of credit, currency, and therefore also of prices within the country in the Central Government of India, a factor militating against the success of any scheme of internal fixation or control and regulation of prices within the province by the Provincial Government?

4. In the absence of any control of the currency and credit system of the country, in the hands of the responsible Provincial Governments, how far would it be possible for Provincial Government to introduce a system of internal barter, so as to reduce the importance of the cash nexus in the settlement of any trading transaction in the Province, and thereby avoid the influence of outside factors affecting the general price level?

5. What are the possibilities of attracting Investment Capital from

(a) other provinces,

(b) other countries

to and in the process of carrying out the programme of Planned Economy as applied to your Province? On what terms and conditions would you consider the attraction of such outside capital for such a purpose?

6. What are the banking facilities available in your Province? To what extent would it be necessary to improve the industrial and agricultural financing now done in your Province and to improve the credit of industrial workers in general?

7. How far have the Institutions named below succeeded in mobilising the Capital Resources of your Province?

(a) Co-operative Societies.
(b) Post Office Savings Banks.
(c) Postal Cash Certificates.
(d) Savings Department of ordinary banks.

8. How far is it possible for the Provincial Government directly by themselves to finance the establishment of new industries in regard to the fixed as well as working capital, or in association with private enterprises?

9. In the event of the Provincial Government or any Local Body, working in partnership with private enterprise, any provincial industry, utility or service, what should be the terms and conditions of such partnership specially in regard to

(a) general supervision over the conduct and management of the concern,
(b) treatment of labour,
(c) interests of consumers,
(d) provisions of reserves,
(e) sharing of profits, and
(f) eventual acquisition of the entire enterprise by Government?

SUMMARY OF DEVELOPMENTS

Many developments have taken place, some of a far-reaching, fundamental character, in the Currency and Banking System, as well as the Credit machinery of this country, in the eventful years during and after World War II. Within the scope of this Volume, it would be impossible to take note of every single Ordinance, Legislation, or executive order, affecting this part of our national economy, and the changes they embody. As explained in the Introduction, many changes have come upon India's domestic and foreign Trade and Finance, which have completely altered the shape of things. The basis of our Currency System,—the silver Rupee,—is now technically, an independent coin. But its links with sterling have not yet been broken. Its silver weight and fineness have been reduced to half since 1942; turned into a nickel coin since 1946, and its design and appearance altered materially. This has, however, no more affected its essential position in the popular mind as the Standard of India's Currency (?) than the changes in the shape and design of the Currency Notes of the several denominations. The demonetisation, early in January, 1946, of the Currency Notes of high denominations, like Rs. 1,000 and Rs. 10,000, was intended as a blow to the Black Marketeer, or war-time Profiteer, who had evaded taxation, and hoarded his ill-gotten gains in these higher denomination Currency Notes.

Changes in the policy of Price Control, with far-reaching repercussions on internal and foreign trade, have been many and varied; and have been noticed more at length in other more appropriate volumes in this Series. Other minor developments could also be mentioned; but the Summary would swell to disproportionate length if one were to include every change, modification, or development in these integral parts of our national economy. Note will, accordingly, be taken only of such changes and developments, which affect the very roots of the system, and have reaction on any scheme of wholesale planning which must be taken stock of before Planning could be perfect and satisfactory.

1. Inflation

Amongst the most important of these developments, pride of place must be given to what has come to be known as Inflation, or the swelling in the volume of Currency in circulation, and the consequent rise in prices, both resulting from the accumulation of Sterling Securities in our Paper Currency

Reserve, and of "cash balances held abroad" in the Banking Department of the Reserve Bank of India. A table given elsewhere shows the rapid increase, since 1939 in the Note circulation; and the one sub-joined indicates the inflation in prices up to the latest date.

Index Number of Wholesale Prices (Sensitive Series) in India by Groups of Articles and Cost of Living in Bombay since 1939-40
(Average of weekly figures.)

Year and Month	General Index	Cost of Living* (Bombay)
1939-40**	125.6	105
1940-41	114.8	109
1941-42	137.0	122
1942-43	171.0	166
1943-44	236.5	226
1944-45	244.2	225
1945-46	244.9	228
1946-47	275.4	252
1947-48	307.0	268

* Monthly indices: Base—August 1939=100; Annual figures are averages of monthly indices. Source: Bombay Labour Gazette.
** Seven months ended March, 1940. Source: Report on Currency & Finance 1948. p. 126.

Index Movement of Wholesale Prices in India. (Base-Year ended August 1939=100).

	July (1947)	June (1948)	July (1948)	% increase (+) or decrease (—) in July 1948 as compared with June 1948	% increase (+) or decrease (—) in July 1948 as compared with June 1947.
I. Food Articles:	291.5	377.0	392.1	+4.0	+34.5
II. Industrial Raw Materials:	371.0	450.8	449.9	—0.2	+21.3
III. Semi-Manufactures:	256.0	323.4	338.2	+4.6	+32.1
IV. Manufactured Articles:	274.9	370.1	370.2	..	+34.7
V. Miscellaneous:	449.8	520.0	537.3	+3.3	+19.5
VI. All Commodities:	297.7	382.2	390.1	+2.1	+31.0

All controls on Foreign Exchanges, all changes and developments in the monetary system, all regulations of local and overseas trade of capital issues etc., are, in one way or another, traceable to this group of problems centering round the question of controlling Inflation, and realising our huge resources locked up in the so-called Sterling Balances. Even the institution of the International Monetary Fund and of the International Bank, are inextricably mixed up with these. The Summary will, therefore, begin with a brief account of this problem.

* Inflation: Concealed Taxation

Inflation has been popularly defined by a recent writer to consist in an enormous rise in the circulation of currency or Legal Tender, particularly Paper Money, backed purely by Government Securities, created, generally, to meet current Budget deficit. No adequate gold, silver, or Foreign Exchange (valuta) cover is provided against this Paper Currency which becomes practically inconvertible. Fresh Notes are issued without any co-relation with the real demand arising out of an increased wealth production, or improved standard of living; and consequent increase in the demand for Medium of Exchange to bring about a better distribution of the goods produced.

All these conditions are found, as shown by the preceding Tables, to have been at work in India during the War years, 1939-45; and, three years after the War, they have not ceased to operate. Attempts at controlling prices of essential goods have failed to yield all the desired results, because of the continued Budget deficit, and, therefore, of the fountain-spring of Inflation. It is, indeed, true, that not every rise in the price-level is to be condemned; since rising prices are often a correct index of growing prosperity, expanding industry, or improved standards of living. But all indices in India today point to the fact that production in Agriculture as well as Industry has fallen; and that the improvement in the standard of living is not at all commensurate with the seeming rise in wages, such as it has been. The problem, therefore, exists in a particularly virulent form, and is becoming progressively more acute.

The growing anxiety caused by this problem has at last been realised by the powers-that-be, who have called in several interests and individuals to advise them as to the ways and

*Cp. "How India Pays for the War" by K. T. Shah, p. 98.

means of dealing with it. Those representing specific interests naturally put forward suggestions suited to their own particular interests, though to any one impartially scrutinising the suggestions, the extent of the common ground among all persons consulted, would appear to be amazing. The independent or non-official economists called in consultation, were probably the least biased, though they are frequently charged by interested parties to be lacking in a sense of practicability. Even so, their recommendations seem to be sufficiently varied, far-reaching, and going to the root of the problem to deserve more than a passing glance in this Summary.

The Economists called into consultation by the Central Government in August, 1948, ascribed the present evil of Inflation to:—

(i) Continuous inflation of currency during the War period to provide funds for the heavy purchases on account of the British Government.

(ii) Continued budget deficits at the Centre, on both Revenue and Capital account, even after the end of World War II, aggravated by deficit budgets in most of the Provinces during the current year.

(iii) Sudden and unplanned removal of controls on prices and distribution of essential goods.

(iv) Increase in active money due to transfer of cash and balances, as well as large scale conversion of capital into cash or balances consequent on the vast migratory movements.

(v) Additions to money supply by open market operations of the Reserve Bank in support of Government securities.

(vi) Pressure of money made in the Black Market, and of incomes evading taxation on prices. No one can say the exact amount of this money; but reliable estimates put it at over 500 crores. Perhaps a good portion of these is lying in secret hoards, or used to buy gold, jewellery or immovable property, all which swell the actual or potential purchasing power.

(vii) Disinclination on the part of the agricultural producer to sell, due to the fall in the burden of his cash obligations and the rise in his money income.

(viii) Decline of industrial output from war-time peaks, because of shortage of material, fuel, stores as well as increased wages.

(ix) Increases in money incomes of several classes.

(x) Failure of Government borrowing and savings campaigns.

These consultants considered the danger to be so grave, that they recommended the country's economy be put on a war footing, and determined efforts made to fight Inflation before it was too late. Others consulted, representing Sectional interests of Capital and Labour, substantially agreed with this diagnosis. The remedies suggested below might create sectional opposition, but public opinion must be aroused and employed in favour of them to meet the present emergency.

These remedies were fourfold:—

(a) Fiscal, (b) Monetary, (c) those relating to Control over distribution, and (d) those concerning increase in production.

A. Fiscal Measures

These are primarily connected with the Central Budget. It is necessary to give early effect to them so as to bring the situation under effective control as soon as possible.

Expenditure: Current and Capital

(i) On the side of expenditure retrenchment should be taken up much more vigorously. War-time and post-war growth of staff in Departments both at the Centre and in the Provinces should be carefully scrutinised for all possible retrenchment. An Economy Committee is in fact actually at work. But it progresses so slowly, and spasmodically, and works on such narrow, uneconomic principles, that many fear, in solving one set of problems, it might give rise to a whole host of others, no less complicated or distressing.

(ii) All expenditure of a social, educational and welfare character should be reviewed carefully. However desirable such expenditure may be, in the present emergency, only so much of this expenditure should be undertaken as can be met from current revenues or additional taxation.

(iii) Defence Budget is also unduly inflated and needs strict scrutiny. In the present world situation, however, one wonders if any large-scale economy or retrenchment is possible on this head. War is actually raging in Kashmir, and others may be in the offing. We have won our independence much too recently to run any avoidable risks in this behalf.

(iv) Grants to Provinces out of the Central Budget, itself in deficit, are inflationary. They should, therefore, be discontinued, except where it could be demonstrated that they would add to the production of essential commodities in the immediate future.

(v) Schemes of current expenditure considered to be productive should also be carefully scrutinised. All such outlay should be commensurate with actual results.

(vi) All other expenditure should be rigorously reviewed; and every pie of waste or unnecessary spending should be ruthlessly avoided.

(vii) Refund or EPT deposits should be postponed, except where such refunds are demonstrably required for productive reinvestment.

(viii) Capital expenditure should be met entirely out of genuine borrowing. All such expenditure not immediately productive should be withheld, however attractive such investments may seem to be in the long run.

(ix) Prohibition programmes were considered as bound to aggravate inflationary trends; and as such ought to be deferred for a more favourable moment.

(x) Proposals for **zamindari** abolition which require compensation to be paid, should be so devised as not to lead to an additional injection of cash into circulation.

Taxation

Having reduced expenditure wherever possible, attention must next be paid to increase revenue resources to fill up the Budgetary gulf.

To this end, it has been suggested:—

(i) The Income-tax Investigation Commission should be armed with all necessary powers to secure to the Treasury as much of the evaded tax income as possibly managed. It is generally believed that this one source alone would, if properly handled, more than suffice to make up the present deficit.

(ii) The introduction of a graduated surcharge on income tax, on personal incomes above Rs. 5000, should be imposed.

(iii) Business Profits Tax should be increased to 25%.

(iv) Personal Super-Tax should be raised to the levels of 1947-48.

(v) Steeply graduated Death-Duties should be introduced.

(vi) Agricultural income tax should be introduced in all Provinces, and should be levied on the same lines as the general Tax on incomes.

(vii) A graduated surcharge on payments of land revenue by holders who pay more than Rs. 200 per annum should be introduced everywhere.

Borrowing.

On the Capital Budget side, the Economists suggested:—

(i) The introduction of Treasury Bills of six months' and one years' duration, at slightly higher rates of interest.

(ii) No increase in the Interest rates on Government borrowing. But the attractiveness of small savings should be augmented (a) by the issue of non-negotiable three and five years Savings Bonds at a higher interest than that now given on negotiable bonds of equal duration; and (b) by the issue of National Savings Certificates for three and five years.

(iii) No significant expenditure be incurred from the collection made for the Mahatma Gandhi Memorial Fund. It should for the time being be invested in Government securities or held in deposit with Government.

(iv) Terminable Government loans maturing should not be repaid immediately if there is any option under the Loan Terms.

(v) Bonus receivable by industrial workers, whose annual incomes exceed Rs. 500, should be made in the form of Savings Certificates;

B. Monetary Measures.

(i) The maximum of the total value of Notes issued by the Reserve Bank of India should be limited to the existing amount, with a margin of discretion to meet genuine variations in seasonal demands.

(ii) All banks be required to hold Government securities to the extent of 25% of their total demand liabilities, provided that the Reserve Bank may permit exceptions in suitable cases. A general freezing of all current accounts deposits has been considered, though for reasons of expediency not recommended as a measure for immediate adoption.

C. Controls.

Capital Issues Controls.

The present system of capital issues control should be modified so as to make capital issues for industrial enterprises as free as possible, although capital issues for financial institutions like banking companies and investments trusts should continue to be scrutinized with the utmost care. This relaxation should be subject to the proviso that where capital is issued by companies and immediate equipment is not available such funds as are raised by the companies should be held in investments in Government securities pending their utilisation as and when real capital becomes available.

Raw Material Controls.

Controls for the allocation of essential materials like steel, cement, etc., should be continued, to help the production of essential consumer's goods.

Import Controls.

Imports of essential consumer's goods should be given preference. The list of goods imported under Open General Licence should be as large as possible. But a policy of discrimination against the imports of non-essential goods should be carried out. The possibility of importing capital goods from countries like Czechoslovakia, Canada, Australia, Japan etc., should be thoroughly investigated.

Export Controls.

Export controls should be exercised with a view to enable the country to implement any bilateral trade agreements which it may enter into for the purpose of securing imports of essential supplies. This could be done either by a complete State Monopoly of Foreign Trade, or by permitting importing countries to buy and export the commodities guaranteed to them under bilateral agreements.

Essential supplies imported in return for such exports should be allocated to industry by Government, so as effectively to increase the production of essential commodities at once. Provision should also be made for the equitable distribution of essential consumer goods obtained as a result of such agreements.

Personal Income Controls.

It is necessary to freeze all personal incomes such as wages, salaries, and dividends, even though it involves some inequality of sacrifice.

Dividends declared by companies should be limited in the case of existing companies to the average of the last two years' dividends. In the case of new companies they should not exceed 6%. Undistributed profits resulting from the dividend limitation should be held as compulsory deposits against one or two year Certificates.

Food Controls.

With the freezing of salaries and wages, government must face the obligation to prevent prices of food-grains from exceeding their existing levels. Ceiling prices should therefore be notified for all food-grains, in both urban and rural areas.

In the urban and industrial areas it is also necessary to arrange for controlled distribution of food-grains through ration shops, in order that the cost of living of industrial workers and other wage and salary earners may be stabilised at levels not much above of those which prevailed before the recent spurt in food prices.

Supplies for this purpose should be obtained from imports and from domestic resources. The latter should be obtained by a compulsory levy imposed on every agricultural holding, yielding more than 25 maunds, supplemented, if necesssary, by purchases in the open market. Prices paid should be the lowest practicable, Government should subsidise the sale of the domestically procured grain on the same basis as imports. The cost of such subsidy must be met out of current revenue.

The Provincial Governments in deficit provinces may extend rationing also to the rural areas provided:—

(i) they do not expect to get any additional quotas from the Centre on this account.

(ii) the prices they pay under any scheme of monopoly procurement should not be very much above the prices at which food-grains are now being sold in ration shops.

Controls of Other Commodities

Control of prices and distribution of cotton and cloth is being reintroduced. It should be elaborated on lines of a state monopoly. Controlled maximum prices should be fixed for oilseed and prices as well as distribution of other commodi-

ties as paper, vanaspati, cement, steel, coal, kerosene, charcoal, sugar, etc. should be continued or reintroduced.

D. Production

A programme of production targets should be laid down for each major industry. Small-scale and Cottage Industries should be fully developed to mitigate the essential shortages.

New companies in the major fields of productive industry should, by way of incentives be granted some rebate of taxes and schemes of production bonuses of significant amounts, based on production above a standard output. All efforts to increase agricultural production should be intensified without delay.

Most of these suggestions are awaiting implementation, pending the Cabinet's decision on basic policy. Individual recommendations have, however, been taken up for being given effect to.

II. Sterling Balances

Another significant feature of the war which was closely connected with, and was the main cause of the problem of Inflation, was the accumulation of huge Sterling Balances in London of the order of Rs. 1,654.71 crores, after the Sterling Debt of the Government of India, amounting to Rs. 429.28 crores, had been repatriated, the sterling being utilised to pay for the earlier War purchases of the British Government and their allies in India. After the War, and in consequence of a provision in the Anglo-American loan, Britain was anxious to settle the Sterling Balances held in London by India and other countries. Temporary agreements were made with India in 1946 and 1947 lasting for 6 months at a time, and releasing a small amount of the balance to be converted into hard currencies. But this kind of tinkering was satisfactory to none of the parties concerned; and so negotiations of a more permanent character were taken in hand in 1948.

A delegation led by the Finance Ministry went to London in June, 1948 after the ground had been prepared by Secretaries as well as by an understanding with the Pakistan Government.

The Sterling assets of the Reserve Bank had declined a during the year by Rs. 29.48 crores as compared with a net decrease of Rs. 120.25 crores in 1946-47. This decline was due mainly to a deficit in the country's international transactions on current account, caused among other factors by heavy im-

ports of food on Government account as well as by permissible capital transfers.

The total Sterling holdings in the Issue and Banking Departments as on 30th June, 1948, amounted to £1,152.50 million or Rs. 1,536.67 crores, which are maintained in the form of cash and investments in short-term British Government securities. Technically these are assets of the Reserve Bank of India which can at any time demand their liquidation from the Bank of England. Interested, however, as the Reserve Bank is in Foreign Trade finance, from its point of view, the rapid depletion of these assets, during the latter half of 1946-47 caused anxiety. They felt that these balances, represented almost the entire Foreign Exchange reserves of the country; and as such should not be used to finance the normal current external deficit. That should rather be met from the earnings of current exports. The accumulated reserves should be drawn upon only for the purpose of importing essential capital goods required for maintaining and increasing the country's productive capacity in agriculture, industry, transport and power generation. On the Bank's representation, Government, decided to follow, from July, 1947, a more restrictive policy in respect of imports. Taken along with the expansion in exports, the result of restricted imports was a rise in the Bank's sterling holdings during the greater part of the second half of 1947-48.

The first interim Sterling Balances Agreement for the period ended 31st December, 1947, which was signed in London on 14th August, 1947, provided for the distribution of India's sterling balances into two accounts with the Bank of England, viz. (1) the No. 1 Account, to which were credited, together with current sterling receipts, a release of £35 million, and a working balance of £30 million, the balance of this account being made available for payment for current transactions anywhere in the world; and (2) the No. 2 Account in which the remainder of the accumulated balances were held and made available only for certain types of capital transactions, and the payment of pensions, gratuities and provident funds outside India.

It was also agreed that the sterling assets of the Reserve Bank would be invested so as not to earn a rate of return appreciably higher than the rate earned as on the date of the agreement.

This agreement was extended in February, 1948, to be in force till 30th June, 1948. India was granted a fresh release of £18 million, after taking into account the excess of £11

million lying to the credit of No. 1 Account over and above the £30 million working balance previously granted. Pakistan obtained a release of £6 million, and a working balance of £10 million, in addition to an amount from the balance in the No. 1 Account due to it under the Indo-Pakistan Agreement of December, 1947. Of the releases granted to India and Pakistan, only £10 million and £3.3 million, respectively, were to be convertible into hard currencies.

The latest settlement was negotiated in June in London, between the representatives of the United Kingdom and the two Dominions for a long-term settlement of the problem of the Sterling Balances. The terms of the agreement then arrived at are:—

This agreement has been arrived at after taking into account the needs of India and her absorptive capacity on the one hand and the present difficult economic position of the U. K. on the other. It provides for the release of a sum of £80 million over a period of three years, which, together with the current balance in India's No. 1 Account of about £80 million constitutes roughly a sum of £160 million available for expenditure over the next three years leaving a reasonably adequate amount of working balance. Also, taking into account the many uncertainties surrounding the position of the sterling area, central reserves of gold and dollars, it was agreed that out of this a sum of £15 million is to be made available in dollars and other hard currencies over a period of one year, this amount being available to India in addition to India's current earnings in dollars and other hard currencies, supplemented by borrowings from the I.M.F. if any. Agreement has also been reached over the purchase of military stores and installations by the Government of India at a cost of £100 million and the purchase of a tapering annuity from H.M.G. for the payment of pensions at a cost of £168 millions, which include Central as well as Provincial Government Pensions.

Nothing has been settled regarding the liquidation of the remaining amount of the Sterling Balances, which aggregate about £800 millions. The present Agreement is expected to last for three years; but with regard to further releases to be convertible into hard currencies, the period allowed is only one year.

The final accounts of the undivided Government of India for 1946-47, showed that a sum of £49 million (Rs. 65 crores) remained due from the United Kingdom under the plan for the allocation of defence expenditure between India and that

country. Certain liabilities pertaining to the period covered by this plan still remain to be met and after allowing for these the final amount due has been fixed at £55 million (Rs. 73 crores). This payment will be in final settlement of all matters arising out of the Defence Expenditure Plan except for certain terminal benefits which will be separately adjusted.

Not only is the Agreement of July, 1948, not final regarding the greater portion of the Sterling Balances, but it is open to criticism, and has been criticised, on a variety of grounds. The entire amount of over £1,152 millions has been taken as a single total, without distinguishing between the amount held in Sterling, in the Paper Currency Reserve or current balance in London at the outbreak of the War. This was estimated to amount to £60 millions; it could on no account have been lumped with the total accumulated during War. It had been suggested to the Finance Minister before the Delegation left to negotiate the Settlement, that these amounts should be kept separate, and insisted to be paid in dollars or gold as part of our Currency Reserves. But the suggestion did not find acceptance; and that amount therefore goes with the rest. Even if these recommendations had been carried out, the amount would, in actual purchasing power, have been much less than the same figure on 1st September, 1939, in terms of real purchasing power. Those who made the suggestion did not insist upon this aspect of the matter being insisted upon; but their moderation was of no avail.

The value of the surplus stores installations, equipment, etc. taken over by the Government of India, from the British Government at the end of the War, has been fixed at a round figure of £100 millions, and the amount agreed to be deducted from the total of sterling balances. No one, however, knows what the real value of these stores, installations, and equipment is.

Much of this is either unusable, obsolete, or impossible to be removed bodily by Britain without incurring a disproportionate cost of transport. Rough estimates made of sample stores, etc. calculated the value of all those at over Rs. 500 crores. But even if these sample valuations should be accepted as giving a correct basis for calculating the total amount involved, the benefit received by India, from the standpoint of serviceability of an up-to-date character of the material, is scarcely commensurate with the amount fixed as the price, and deducted from the total sterling due to us.

The amount agreed upon as capitalised value of pensions may not call for criticism, except, perhaps, on grounds of the

technique of calculations. But the fact that no agreement has been reached, and no settlement made for the very large sum still remaining outstanding, provides the strongest grounds for dissatisfaction with the arrangement. No security or guarantee has been taken regarding the eventual realisation of this amount; no steps have been taken to raise equivalent funds to facilitate the import of food or capital goods from hard currencies areas if necessary, by raising loans in those countries secured from these assets of India held in Sterling. We have capacity of our own to raise and guarantee such loans. But if they are further secured by such assets belonging to us, the terms of such loans would be much easier, and our task of importing goods from such areas much simpler.

Finally, no pledge has been taken from the British Government that, in the event of no satisfactory settlement being made of the amount still outstanding, (payment being made preferably in gold or its equivalent for any reasonable proportion of this amount) the assets owned by British nationals in India would serve as security for India to realise the amount still remaining due to her. The fact, already mentioned, that the settlement is only for a comparatively brief period is another source of anxiety, at least to those who fear the chances of the economic recovery of Britain up to the Pre-War level not as bright as might be hoped that such claims as ours may be satisfied. Add to these the political complications and the danger of the war-like operations which is imminent in the present conflict of rival imperialism and we can understand why the problem of Sterling Balances still unsolved should give continued ground for serious anxiety.

III. Control and Co-ordination of Banking

Note has already been taken in the Introduction of the striking lack of co-ordination in the Banking and Credit organisation of the country. To obviate this defect, and to ensure the greater safety of Deposit holders in Banks, a Bill was brought before the Indian Legislature in 1946 to consolidate the law relating to Banks and Banking. This however, could not be enacted owing to the rush of political developments, culminating in the establishment of Dominion Government. The Constituent Assembly (Legislative) of India has had that proposal once again placed before it, in its autumn sessions of 1948. But the Select Committee appointed on that Bill could not proceed very far, and the enactment has been again postponed. To achieve, however, the principal objective of the proposed legislation, an Ordinance was passed in September, 1948, which gives the following powers and authority to the

Reserve Bank, to ensure the safety of Depositors in Banks.

(1) The Reserve Bank is authorised to grant advances to scheduled and non-scheduled banks in emergencies against such form of security as the Reserve Bank might consider sufficient. This will enable sound banks to be assisted more freely if they get into difficulties.

(2) Grant of unsecured loans and advances by banking companies to directors and to firms and Private Companies in which the directors are interested is prohibited.

(3) Banking companies are required to submit to the Reserve Bank returns of unsecured loans to public companies in which the directors are interested. This is intended to guard against injudicious investment by directors.

Maintenance of Assets

(4) Banks must maintain, at the end of each quarter, assets in India, not less than 75 per cent of their demand and time liabilities in India, so as to prevent foreign Banks operating in India from transferring too large a portion of their assets outside India to the detriment of the depositors' interests.

(5) The Reserve Bank is empowered to control and direct banking companies in regard to their lending policies, so that, where necessary rising prices may be checked by control of credit facilities, or creation of deposit currency.

(6) The Reserve Bank is empowered to apply to a competent Court to be appointed official liquidator, so that, where necessary and possible it may arrange for the orderly liquidation of a bank that is being wound up.

(7) The Reserve Bank can also prohibit a banking company from indulging in practices detrimental to the interests of depositors.

(8) Amalgamations with other Banks or schemes of arrangements or compromise with creditors are prohibited without the concurrence of the Reserve Bank. Thus schemes which are detrimental to depositors' interest would not be adopted.

(9) It also empowers the Reserve Bank to assist as intermediary in proposals for amalgamation.

It is hoped that by this means the country's banking structure would be strengthened, and some undesirable practices which have recently crept in would be stopped.

There is nothing in this Ordinance to stop unnecessary multiplication of Branches, which are deemed, in orthodox banking circles, to be a source of weakness. Figures given in the Introduction, however, would go a long way to show that India is still lacking in adequate number of Banks for its population. There is, moreover, nothing in the Ordinance, and not

even in the Bill as it stands now, to show that the more glaring shortcomings of our Credit Organisation or the functioning of the Banks, are being perceived and much less remedied. For instance, the provision of special type of Banking or aiding Industry or Agriculture so as to contribute directly to increase the productivity, is utterly absent at least in so far as the recently established Industrial Finance Corporation can be said to meet that end.

In other respects also, like economising the use of Currency by devising special forms of credit instruments and adapting them to the requirements of the Indian clientele, the Bill does not make any provision. The guiding principle of the Bill is simply to safeguard the interests of the depositors. There is no thought of the function of the Bank in the economic life of the country and therefore no provisions regarding the special training, aptitude, or qualifications by way of experience, etc. of those who have the direction and management of Banks in India.

Until, therefore, the defects noticed both in the Currency System and in the Banking Organisation are properly corrected; until the two are properly correlated inter se, and until both are made integral part of planned economy, all the benefit that we can reasonably expect from modernised banking would be lacking.

IV. Controlled Foreign Exchanges

The strain being increasingly felt, even during War years, on the stable maintenance of exchange ratio was attempted to be relieved by the Lease Lend system, in which India participated only indirectly and comparatively slightly. The arrangement, however, was a purely war-time measure, whose benefit, it was expressly provided, would stop as soon after the War was over, as possible. It was, therefore, necessary to make some arrangements, for the continued stability in exchanges all over the world, if the war worn countries were to recover and rehabilitate themselves as soon as possible. Britain was the first to realise this; and she applied for a long term loan as soon as the Lease Lend system came to an end. The conditions of the Loan, eventually granted in 1946, were such that Britain was obliged under it to wind up the "Empire Dollar Pool", to liquidate the Sterling Balances, to maintain stable exchanges, to forego any policy of discrimination in trade, etc. It was under this agreement that she was forced to take steps for settling the problem of Sterling Balances, already referred to.

The United Nations' Monetary and Financial Conference held at Bretton Woods (N. H.) in July, 1944, arrived at an agreement by which a concrete programme for international

monetary and financial co-operation including stability of exchanges was worked out. Forty-four nations were represented in the Conference and they signed an agreement concerning the setting up of an International Monetary Fund and an International Bank for Reconstruction and Development.

The agreement signed as the result of the Bretton Woods International Monetary Conference of 1944, is designed to ensure stability of international exchanges. All participating nations agreed to fix the ratios in exchange of their several national currencies in terms of gold. This exchange ratio was not absolutely rigid and inflexible. A margin of 10% variation was permitted, under stress of temporary difficulties. Beyond this, no variation is allowed, except with the consent of the Managing Board of the International Monetary Fund, which was established to control and regulate the working of this system. The Board can consent to a further variation up to a maximum of another 10% of the fixed gold value of a national currency, except under very special conditions of a momentary emergency.

The main object of the International Monetary Fund is to provide member countries with short-term resources (based on the quotas allotted to each country) to enable them to tide over temporary deficits in their international balance of accounts, and so maintain stability of exchange, which was deemed essential to the balanced rapid recovery of war worn countries, and a revival of International Trade. This Fund was to aggregate £2,000 millions, and was to be built up by quotas from members who paid in gold, local currencies and securities. India's quota is fixed at £100 millions—$0.4 billion. The quota is fixed in accordance with a country's position in the international trade, and to govern its borrowing rights, voting rights and share in the management.

No country agreeing to these arrangements, can thereafter regulate its local currency to suit the needs of its own local economy, or of its own trade with other countries. At the same time, each participating country's right to regulate and control its own Foreign Exchange supplies was practically eliminated, except in regard to long term capital investment. Before this agreement a country could devise its fiscal system, so as to direct its foreign trade towards such countries whose currencies were more easily obtainable in exchange, and restrict it as regards those other countries whose currencies were not as easily obtainable. The agreement arrived at at this Conference was to exclude such preferences, after a period of transition from war to peace economy. Each country is now bound to supply any amount of any currency for current (not capital) transactions to holders of its own currency; and this can be

done by drawing upon the International Monetary Fund to a limited extent, in addition, of course, to the normal earnings of the country concerned of other hard currencies. These limits are fixed by and upto the credits to which a member country has become entitled. When these credits are exhausted, and the country still continues to need Foreign Exchange, no normal remedy is provided under the agreement. The only recourse then left to such countries would be to bring about drastic Deflation at home or currency devaluation permitted under the scheme.

There is yet another clause of the Agreement, whereby, if the demand for a given currency continues to be in excess of its supply, the Directors of the International Fund can authorise the member countries to reimpose Exchange controls in regard to such "scarce" currency. At the present time and for years to come only the American Dollar can come within the category of such likely "scarce" currency unless and until the United States either dispense with their own tariff walls, and so facilitate the import of foreign goods, to set off against their excess of exports; or lend to other countries suffering from war wastage until the latter's local economy is rehabilitated sufficiently to permit them to balance their international account.

V. The International Monetary Fund

Although the International Monetary Fund commenced its operations from 1st March 1947, the first exchange transaction took place only towards the end of May 1947. A stabilisation credit of $.25 million was granted to France and of $.12 million to the Netherlands, one half of the latter being in pound sterling.

The growing deficit in her balance of payments with the United States led India to apply for the first time to the Fund for purchase of dollars in March 1948, and succeeded in securing initially an amount of U.S.$.28 million in March, followed later by two instalments of $8.06 million each in May and June, by tendering the equivalent in rupees.

Along with most of the other members, India also availed herself of the transitional arrangements regarding exchange restrictions. The imbalance in the international payments position of many countries following a decline in production or shortage of essential supplies from certain regions whose currencies were scarce, compelled many countries to restrict Exchange facilities, not strictly in consonance with the principles of the Fund. The actual position was, however, very acute particularly in regard to food in India. Time is needed to restore suitable conditions. The Fund, after declaring its

policy in respect of multiple currency practices, generally agreed to the adaptation, subject to certain principles, of existing Exchange Controls and Currency Devaluation in a few countries. It was hoped that, by helping to iron out balance of payments difficulties in the immediate future, these measures would enable the countries concerned to return to more normal Exchange practices. The Fund would then be able more easily to achieve its long-term objectives of Exchange stability without needless recourse to exchange restrictions.

In June 1947, the Fund issued a directive to all member countries warning them of the undesirable consequences of external sales of gold at prices above monetary parity. Members were asked for active co-operation in eliminating such deals.

In December 1947, the Fund declared its policy against subsidies to gold production. Any member, proposing to introduce such subsidies, was requested to consult the Fund on the specific measures contemplated. In April 1948, the Fund declared that, during the first year of the European Recovery Programme, members participating in the Programme, should apply for the purchase of U.S. dollars only in case of exceptional or unforeseen hardship, so that the resources of the Fund may be maintained at a safe and reasonable level, and at the end of the E.R.P. period, such members may have unencumbered access to the Fund's resources.

VI. International Bank of Reconstruction and Development

Side by side with the creation of the International Monetary Fund, for the more effective management of that Fund, as well as for the fuller realisation of the main objective of rapid post-war recovery from war wastage, loss or damage, an International Bank was set up, to provide long term capital for investment in reconstructive or developmental projects. The Bank, in fact, is called the Bank for Reconstruction and Development. It has a capital stock of $10,000 million, of which only 20% is called up in the initial years of its existence. The rest will be called up as and when needed. Every country which joins the International Monetary Fund must subscribe to the Bank, either directly through its Government, or through its Central Monetary and Credit organisation. Ten per cent, of the capital called up must be paid in gold or dollars, while the balance may be paid in the country's own currency.

With these resources, the Bank can make loans, or guarantee loans raised elsewhere, upto a maximum amount equal to the capital subscribed by it. These loans are to be only for

specific projects of reconstruction or development, which include, however, restoration of assets damaged by or lost during war. For this purpose countries who have suffered during the War from enemy occupation, or because of warlike operations having been carried on on its soil, will be particularly attended to in the loans or guarantees of the Bank for Reconstruction and Development.

The Bank's loans are made to the Government of a member country, or to any business, industry or agricultural enterprise. If such loans are made to non-Government bodies, the Government of the country, in which the loan is to be spent or work is to be executed, must afford a guarantee of the repayment of principle and interest on the loan.

The loans, moreover, are made only when the Bank is "satisfied that, under the prevailing market conditions, the borrower would be unable to obtain the loan as reasonably." Each project for which a loan is to be raised,—usually the provision of some Public Utility, must be carefully scrutinised by an expert Committee, and only on that Committee's approval would the loans be given.

Besides making its own loans, the Bank may subscribe to loans raised by other agencies, on a much larger scale. It is authorised to borrow money for subscribing to such loans, and, also to guarantee loans and make a charge of 1% or 1½%.

The Bank thus contributes to long-term equilibrium in the international balances of payments. The Indian delegation to the Monetary Conference pressed for some provision for a partial multilateral clearing of the wartime Sterling Balances through the machinery of the Fund, in the interests alike of the economic development of the backward countries, as well as of the expansion of multilateral trade, which would assist effectively the broad objectives of the International Monetary Fund. The proposal, however, was rejected by the Conference on the ground of the limited size of the Fund in relation to the magnitude of the war balances. Another claim by our delegation for the allotment of a larger quota, and for a permanent seat on the Executive Committee of the Fund as well as of the Bank, was also rejected, though our quota is large enough to assure continuous election to the Executive Committee of the two institutions.

It may be added that these Articles of Agreement await ratification by the Governments of the participating countries, and will come into force when the Agreement is signed on behalf of Governments having 65 per cent. of the total quotas.

The International Bank for Reconstruction and Development began active operations in May, 1947. Its first and, so

far, the biggest loan of $250 million was granted to France. The next lot of loans, aggregating $263 million, was for the Netherlands, Denmark, Luxemburg and Chile. They are to be repaid gradually over periods varying from 6½ to 30 years and bear rates of interest ranging from 2¾ to 3½ per cent. This is in addition to a uniform commission of 1 per cent which will help form the Bank's Special Reserve. According to its report for the year ending June, 1948 $525 million had in all been thus loaned out.

Almost all the loans are in U.S. dollars except in the case of Luxemburg, where the loan is in Belgian Currency, and Netherlands in whose case the loan is in Swiss Francs. They are meant, in the case of the European countries, for financing imports of capital goods and equipment needed for the reconstruction and rehabilitation of vital sections of industry affected by the war. In the case Chile, the loan is intended to aid in hydro-electric and agricultural development. Other members have also applied definitely for loans, or are conducting preliminary negotiations with the Bank.

In July 1947, the Bank launched in the United States two series of bonds, one with a maturity of 10 years and the other with a maturity of 25 years, the amount of the issues totalling $ 250 million both being heavily over-subscribed. Again in May 1948, another series of such bonds of 17 million Swiss Francs was placed upon the Swiss Market to the value of 17 million Swiss francs, the entire issue being taken up for investment by the Bank for International Settlement. This is some earnest of backward or undeveloped countries getting substantial aid from this Fund; and India may well hope to benefit from it in-regard to her programme of planned development of all her latent resources.

The second Annual Meeting of the Boards of Governors of the Fund and the Bank in 1947 decided that the original quota in the Fund, and the subscription to the capital stock of the Bank of the undivided India should continue to be the "quota" and "subscription" of the new Dominion of India.

VII. Cessation of Rupee as Legal Tender

With the cessation of the legal tender character of the standard coin with effect from November 1, 1943, the quarternary rupees, issued from December 1940, upto the end of May 1946, nickel rupees issued from June, 1947, and the Government of India one rupee notes, constitute as from that date the total amount of rupee coin in circulation. Their aggregate circulation stood at Rs. 123.81 crores at the end of October 1943. The circulation of rupee coin rose to Rs. 137.33 crores at the

end of 1943-44 and to Rs. 147.38 crores at the end of 1944-45. By the end of the war, the total absorption of legal tender currency was 1198.64 crores of which notes totalled 988.89 crores, 82.5%, rupee coin 142.16 crores or 11.9%, small coin 69.59 crores or 5.6%. The total rupees in circulation at the end of 1947-48 was 155.33 crores; the record being in 1946-47 at 167.67 crores.

While the metallic coin continued to be in demand in the interior, a marked partiality for the more convenient and handy rupee note became popular in urban areas. The issue of one rupee notes, however, was restricted, so that the demand for quarternary rupees has gone up. At the end of March 1948, the proportion of the Notes of several denominations is given in the Introduction.

The demand for small coin continued unabated throughout the War. At one time there was an acute shortage felt in the principal cities, and greater quantities were minted and absorbed. The absorption of small coin during 1944-45 amounted to Rs. 19.20 crores as compared with Rs. 18.46 crores in 1943-44, Rs. 11.64 crores in 1942-43, Rs. 5.06 crores in 1941-42 and Rs. 2.21 crores in 1939-40. In 1946-47 Rs. 5.91 crores of small coin were absorbed while in 1947-48 the figure was still lower at Rs. 3.98 crores. It accounted for 31.3 per cent. of the total absorption of Rs. 67.89 crores since September, 1, 1939. The tendency is very marked towards declining absorption of new small coin.

K. T. SHAH.

APPENDIX

MEASURES TO FIGHT INFLATION

While these pages were going through the Press, Government announced their broad general policy in regard to the still unchecked rising spiral of prices. They have taken Fiscal as well as Financial aspects of the situation into consideration, no less than direct incentive to increasing production, and rationing and control over distribution for the essential commodities of life.

On the financial side, the most urgent need is to fill up the budgetary gap between revenue and expenditure, both in the Centre and Provinces from next year, and effort should be made to bring about surplus Budget all over the Union. A Cabinet Committee is set up to carry out an urgent review of all Development plans, both Central and Provincial, and to determine the relative priority of accepted Development schemes, so that expenditure on non-productive schemes might be deferred or curtailed. Lest inopportune haste in social reform should sabotage the Plan, the Provincial Governments have been warned that they could expect no financial assistance from the Centre in implementing their plans for the abolition of Zamindari or for Prohibition, which might either involve excessive borrowing, or unbearable loss of revenue. To meet the present deficit in some Provinces, the latter are advised to strengthen their finances by the levy of an Agricultural Income Tax where it is not now levied. In cases, however, where the Land Revenue is a more direct charge of the State on the tenant, and so requires assimilation with the Income Tax some loss may have to be faced on this head, which may not all be made up by levying a surcharge on all land revenue payments above a given figure,—say Rs. 200/- per annum. The progress of the Estate Duty Bill, now before the Central Legislation, will also be expedited. But even if passed before next March, it is doubtful if the proceeds from that source would be available in 1948-49.

As regards prices, the policy of decontrol, adopted last December, was reviewed, and the revised policy of control on foodgrains and textiles has been announced. This is intended to secure an equitable distribution of foodgrains and cloth at reasonable prices well below the existing levels. After long consideration Government decided not to reintroduce ration-

ing in sugar, but they are taking steps to reduce its price. They also would adopt measures to secure better distribution of essential commodities like kerosene, iron and steel and cement.

Government consider one of the main causes of the present crisis to be the existence in the hands of large sections of the community of purchasing power far in excess of the available supply of goods. It results in a progressive increase in prices. This position will improve if the public invest more in Government loans and in savings schemes. In order to stimulate investments Government propose, in co-operation with the Provincial Governments and States, to intensify the campaign for small savings. They have also decided to afford wider facilities for investments by the small investor in post offices. The maximum permissible limit for investments in postal savings banks will be raised from Rs. 5,000 to Rs. 10,000 and in National Savings Certificates from Rs. 15,000 to Rs. 25,000. Treasury Deposit Receipts will be issued on favourable terms for 6, 9 and 12 months to cater for institutional investors seeking short term use of their funds.

Concessions to Industry. In the field of industrial production, Government consider special steps are necessary to stimulate production. They have, therefore, decided to grant the following concessions:—

Firstly, the present rules regulating allowance of depreciation on plant and machinery for Income-tax purposes will be liberalised. This may mean some loss in revenue; but it is worth while incurring if the main problem is to be satisfactorily tackled.

Secondly, new industrial undertakings will be exempted from income-tax for a specified period.

Thirdly, raw materials and plant and machinery, imported into the country for industrial purposes, will be granted such relief in Customs Duty, as would not injure Indian manufacturers of similar goods.

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